ALAGAPPA UNIVERSITY

(Accredited with 'A' Grade by NAAC)
Karaikudi 630 003

DIRECTORATE OF DISTANCE EDUCATION

MBA (B & F)

Paper - 4.4

Mutual Fund Management

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UNIT 1

1.1 MUTUAL FUND - DEFINITION AND CONCEPT:

Mutual funds have become the investment of choice for millions of investors. The basic idea of a mutual fund is simple. It is an organization whose only business is the investment of its shareholders' (Unit-holders') money into cash equivalents (money markets), stocks, bonds or a combination of stocks and bonds, for the purpose of achieving specific investment goals. To do this, it attracts funds from many individual and institutional investors, and it attempts to invest and manage those funds more effectively than investors could do on their own. More and more investors are using mutual funds to achieve at least some of their investment goals.

The fast growing mutual fund industry in India is regulated by the Securities and Exchange Board of India (SEBI). A Mutual fund in India is registered / incorporated as a public trust. As per Clause 14 of SEBI guidelines- A mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed, duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908) executed by the sponsor in favour of the trustees named in such an instrument. If the Trust Deed so provides the trustees can appoint an Asset Management Company for the day to day administration of the MF and investment of its funds.

1.2 DEFINITION OF MUTUAL FUNDS

Mutual Funds can be defined in the following ways :

1. A mutual fund is an intermediary institution which pools the resources collected from public and invest them in profitable avenues. The funds uses the savings mobilised for investment in debentures, equity shares of various companies, bonds, Government securities and other money market instruments etc., The earning derived out of the investments are distributed among the investors after deducting administrative expenses.

2. Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document

3. A mutual fund is one which pools resources from several investors and manages the same by investing in different financial instruments, schemes with an objective to maximise the returns for the investor members.

4. Mutual Funds are associations or trusts of public members who wish to make investments in financial instruments or assets of the business sector or corporate sector for the mutual benefit of the members. The fund collects the money and invest them in a diversified portfolio of financial assets with a view ti reduce risks and to maximise the income and capital appreciation for distribution to the members on a pro rata basis.

5. Mutual funds are collective investment vehicles that pool together the funds of a number of investors to invest on their behalf. The funds are invested in a variety of stocks, bonds and other marketable securities.

6. A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them.

7. Mutual Fund is essentially a mechanism of pooling together the savings of a large number of small investors for collective investment, with an avowed objective of attractive yields and capital appreciation, holding the safety and liquidity as prime parameters

8. Securities and Exchange Board of India (SEBI)'s Website on Mutual Fund defines Mutual Fund as under:

   i) A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal.

   ii) Anybody with an investable surplus of as little as a few thousand rupees can invest in Mutual Funds.

   iii) These investors buy units of a particular Mutual Fund scheme that has a defined investment objective and strategy

iv) The money thus collected is then invested by the fund manager of the Mutual Fund in different types of securities.

v) The investments could range from shares to debentures to money market instruments, depending upon the scheme's stated objectives.

vi) The income earned through these investments and the capital appreciation realised by the scheme are shared by its unit holders in proportion to the number of units owned by them.

From the above definitions, it is very clear that mutual fund is a vehicle for systematic investing of pooled individual investments in a collective way for the benefit of the investors and maximising their returns.

The money collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them. Mutual funds employ professional fund managers to track markets and spot investment opportunities. The expertise of the fund managers enable them to spread the investments across a diverse portfolio, across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all the securities may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unitholders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives, which are launched from time to time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

Mutual Funds offers several benefits to an investor such as potential return, liquidity, transparency, income growth, good post tax return and reasonable safety. There are number of options available for an investor offered by a mutual fund.

The concept of mutual funds can be briefly summarised as follows:

1. Mutual Funds are investment vehicles where pooled money from various investors is invested as units with a common investment goal.

2. Mutual Funds are managed by their Asset Management Company (AMC)

3. Mutual Funds offer different type of schemes.

4. Investment in one or more schemes can be considered by the investors in one or more schemes of Mutual Funds.

5. Investors by investing in the schemes of mutual funds become the unit holder of the scheme/s.

6. Monies invested in different schemes by the investors are invested by the mutual funds in different types of securities according to the investment objectives of the particular scheme.

7. Even small amounts can be invested by an investor in a mutual fund.

8. The investors get return/capital appreciation or both for the investments based on their investment objectives.

According to Stephen Littauer, author of "How to Buy Mutual Funds the Smart Way" (Dearborn Financial Publishing, Chicago, 1993), one of the most important reasons why investors choose mutual funds is the availability of past performance records. You can see a complete and unquestionable picture of what a fund has achieved in the past. However, past performance may not be an indicator of future performance. To help you achieve your investment objective, mutual funds can provide you with the three basics of prudent investing: (1) careful selection of securities, (2) diversification and (3) liquidity.

Mutual Funds schemes are managed by respective Asset Management Companies(AMC) sponsored by financial institutions, banks, private companies or international firms. The biggest Indian AMC is UTI while Alliance, Franklin Templeton etc are international AMC's. The details of various mutual funds and the schemes offered by them are discussed in the later part of the material.

1.3 WORKING OF MUTUAL FUND - FLOW CHART

The working of the mutual funds is represented by the following flow chart

INVESTORS invests their monies in

→MUTUAL FUND (TRUST) floated by a sponsor company, who through their

→ ASSET MANAGEMENT COMPANY invests the monies in

→DIFFERENT SCHEMES offered, by professional

→FUND MANAGERS who are experts in the field based on the

→FUND OBJECTIVES, based on the scheme, make

→INVESTMENTS in different securities and earn

→ RETURN & CAPITAL APPRECIATION (scheme based)

→ MINUS CHARGES/FEES (LOADS) for the services and return to

→INVESTORS with return/capital appreciation.

Thus the working of a mutual fund starts with the investor and ends with the investor .The mutual fund acts as a financial intermediary which helps the investors through different schemes, to enable the investors to achieve their financial goals. To achieve this objective, the mutual fund operates through an organisational set up prescribed by statute and the same is explained in the next chapter.

2.1 MUTUAL FUND - GENESIS

As explained earlier, mutual fund is a concept of mutual help of subscribers for portfolio investment and management of these investments by experts in the field. The concept of mutual fund is not new.

The first mutual fund, The Societie General de Belgique (Netherlands), which was formed in 1822,embodied the concept of risk sharing.

The second mutual fund was started in Scotland in the 1880's.

The idea of pooling money together for investing purposes started in Europe in the mid-1800s.

In England, The Foreign and Colonial Governments Trust of London was the real pioneer in the field of mutual fund.

In United States of America (USA), mutual funds have evolved over a period of seven decades. Originally called investment trusts, the first American one was the New York Stock Trust, established in 1889. The first pooled fund in the U.S. was created in 1893 for the faculty and staff of Harvard University. After that the origin of mutual funds in the USA dates back to the formation of the Massachusetts Investors Trust in 1924. When three Boston securities executives pooled their money together in 1924 to create the first mutual fund, they had no idea how popular mutual funds would become. On March 21st, 1924 the first official mutual fund Massachusetts Investors Trust was born.

Subsequently the mutual funds that came into existence began their operations in Boston in the early 1920's, Some of the examples are State Street Fund, Massachusetts Investor's Trust (now called MFS), Fidelity, Scudder, Pioneer, and the Putnam Fund. The Wellington Fund, the first balanced fund that included both stocks and bonds, was founded in 1928, and today is part of the giant Vanguard Funds Group.

After one year, the Massachusetts Investors Trust grew from $50,000 in assets in 1924 to $392,000 in assets (with around 200 shareholders). The first fund which set up in Boston in 1924 has grown rapidly with Assets Under Management (AUM) of US $ 448 million in 1940 to more than 50 billion in the early seventies and further to more than US $ 2.1 trillion at the end of 1994.The number of funds in operation has also gown from 426 in 1975 to 1528 in 1985 ad further to a staggering figure of 5761 by the end of 1995.In the USA, the mutual funds have grown into the second largest financial intermediary after commercial banks, with $2.82 trillion in assets by the end of 1995. There are over 10,000 mutual funds in the U.S. today totaling around $7 trillion (with

approximately 83 million individual investors) according to the Investment Company Institute.

Growth for the industry during the first 27 years was slow. In 1951, the number of funds surpassed 100 and the number of shareholders exceeded 1 million. The stock market crash of 1929 slowed the growth of mutual funds. In response to the stock market crash, Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934. These laws require that a fund be registered with the SEC (U.S. Securities and Exchange Commission) and provide prospective investors with a prospectus. The SEC helped create the Investment Company Act of 1940 which provides the guidelines that all funds must comply with today.

With renewed confidence in the stock market, mutual funds began to blossom. By the end of the 1960s there were around 270 funds with $48 billion in assets.

In 1976, John C. Bogle opened the first retail index fund called the First Index Investment Trust. It is now called the Vanguard 500 Index fund and in November of 2000 it became the largest mutual fund ever with $100 billion in assets.

One of the largest contributors of mutual fund growth was Individual Retirement Account (IRA) provisions made in 1981, allowing individuals (including those already in corporate pension plans) to contribute $2,000 a year. Mutual funds are now popular in employer-sponsored defined contribution retirement plans.

Hundreds of mutual funds both open and close ended have been developed and expanded in many countries in Europe, the Far East and Latin America, subsequently after the US phenomenon.

All over the world, there has been a sharp increase in investor preference for mutual funds and India has proved to be no exception.

In the 1960's there was a phenomenal rise in aggressive growth funds (with very high risk). Sometimes called "go-go" or "hot-shot" funds, they received the majority of the billions of dollars flowing into mutual funds at that

time. In 1968 and 1969, over 100 of these new aggressive growth funds were established.

A severe bear market began in the autumn of 1969. People became disillusioned with stocks and mutual funds. "The market's toast. it'll never get back to where it was!" was echoed by panicked investors.

Unemployment grew, inflation went crazy, and investors pulled billions back out of the funds. They should have hung in there! Many funds have risen 9,000% since then.

The 1970's saw a new kind of fund innovation: funds with no sales commission called "no load" funds.

In 1976, John C. Bogle opened the first retail index fund - First Index Investment Trust (now the largest index fund - Vanguard 500 Index) and the next year Peter Lynch took over at Fidelity Magellan, now the largest stock mutual fund

The largest and most successful no load family of funds is the Vanguard Funds, created by John Bogle in 1977. At the end of the 1920's there were only 10 mutual funds. At the end of the 1960's there were 244. Today there are more than 6,500 unique funds and even thousands more that differ only by their share class (how they are sold, and how their expenses are charged).

In 1981, Congress created the Individual Retirement Account and by the end of the 80s there were 2,917 funds and $982 billion in assets.

The next big change for the industry was in 1991 when Morning Star introduced its "star ratings." By 1994, 75% of all new investments were in funds with a rating of four or five stars.

In 1992, Charles Schwab started One Source, the first "fund supermarket."

As of December 1998, stock mutual funds account for $2.981 trillion or 53.9% of total mutual fund industry assets. Money market funds account for 24.5% ($1.353 trillion), bond funds comprise 15.0% ($830.5 billion), and hybrid funds hold 6.6% ($365.1 billion). Mutual funds held about 20% of all publicly traded U.S. stocks in 1998. The remaining 80% was held by households, private pension funds, state and local government retirement funds, insurance companies, private trusts, residents of foreign countries, and other investors.

These numbers are gathered by the Investment Company Institute. The popularity of the Mutual Fund has increased manifold. In developed financial markets, like the United States, Mutual Funds have almost overtaken bank deposits and total assets of insurance funds. As of date, in the US alone there are over 7,000 Mutual Funds with total assets of over US $ 3 trillion (Rs. 100 lakh crores). According to "The Investing Kit" (Dearborn Financial Publishing, Inc., Chicago), mutual funds offer "professional portfolio management, diversification, a wide variety of investment styles and objectives, easier access to foreign markets, dividend reinvestment, ease of buying and selling shares and exchange privileges.

But the highlight of the concept of mutual funds is that since 1940 no mutual fund has gone bankrupt.

Mutual funds are very popular today, known for ease-of-use, liquidity, and unique diversification capabilities.

3.1 GENESIS AND GROWTH OF MUTUAL FUND INDUSTRY IN INDIA

Unit Trust of India (UTI) was the starting point of mutual fund history in India, way back in1964. The vision and foresight of the then finance minister, the late Shri. T.T. Krishnamachari (TTK) to channelise the funds of small investors into the capital market by creating an institution, resulted in the formation of UTI. The government engaged David Silver, known as the father of mutual funds, as one of the consultants, to create a mechanism and devise an instrument for these investors.

The growth of mutual fund industry in India can be explained in four distinct phases

i. Formation of Unit Trust Of India

ii. Setting up of mutual funds by public sector banks and financial institutions

iii. Setting up of mutual funds by private and foreign players.

iv. Bifurcation of Unit Trust of India into two separate entities.

i) Formation of Unit Trust of India

The first phase of the mutual fund history started with the establishment of Unit Trust of India (UTI) on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs.6,700 crores of assets under management.

UTI was the only mutual fund operating for a long time since 1964. It was an open-ended mutual fund whose units can be sold and repurchased at any time. UTI is a public sector mutual fund enjoying a monopoly position until 1987 and special tax benefits were offered exempting entire income from income tax initially. Subsequently, the exemptions were slowly changed

UTI evolved as a government promoted organisation, which combined in itself the functions of a mutual fund and a financial institution. As a result, UTI was allowed to participate in term financing, which today's mutual funds do not do. Its activities as a financial institution were in keeping with the ethos of the times, which required us to promote industries and also promote the capital markets. By 1987, UTI was managing assets worth Rs 40,000 crores. That was the first phase of the mutual fund sector in India.

ii) Setting up of mutual funds by public sector banks and financial institutions

The second phase of the sector's growth came in 1987 with the entry of government-owned banks and financial institutions like the Life Insurance Corporation, the General Insurance Corporation and others being permitted to set up their own mutual funds. Government allowed public sector banks and institutions to set up mutual funds following an amendment in the Banking Regulation Act in 1983. The Act empowered the Reserve Bank of India to permit the banks to carry on non-banking business such as leasing, mutual funds etc., under Sec 6 of the Act. Following the amendment, State Bank of India, Canara Bank, Punjab National Bank and some other nationalised banks have set up their own mutual funds. Others followed the trend set by the above banks.

SBI Mutual Fund was the first non- UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. With their entry, mutual funds started penetrating the semi-urban and rural areas and by 1993, the mutual fund market had grown to about Rs. 80,000 crores.

iii) Setting up of mutual funds by private and foreign players

The liberalisation policy, which came in 1993, opened the mutual fund sector for private and foreign participation. Taking advantage of the liberalisation, most of the leading foreign funds have set up their operations in the country. That has brought many advantages such as high benchmarks in quality and customer service, which are comparable to the best in the world.

A new era has started in the Indian mutual fund industry, with the entry of private sector funds in 1993. This has given Indian investors a wider choice of fund families to choose from. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

iv) Bifurcation of Unit Trust of India into two separate entities

Unit Trust of India Act 1963 was repealed in 2003 and UTI was bifurcated into two separate entities.

One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs.29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations.

With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs.76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth. As at the end of September, 2004, there were 29 funds, which manage assets of Rs.153108 crores under 421 schemes

3.2 ROLE OF SEBI:

The Mutual Fund Industry was brought under the control of Securities and Exchange Board of India (SEBI) and opened for private sector participation in 1993.

In order to regulate the mutual funds under a single regulatory agency, in the year 1992, Securities and Exchange Board of India (SEBI) Act was passed. The objectives of SEBI Act are mainly to cover the following:

I. To protect the interest of investors investing in mutual funds

II. To promote the development of mutual funds and securities market and

III. To regulate the securities market.

As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines to the mutual funds from time to time to protect the interests of investors.

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. The

risks associated with the schemes launched by the mutual funds sponsored by
1613 these entities are of similar type. It may be mentioned here that Unit Trust of India (UTI) is not registered with SEBI as a mutual fund (as on January 15, 2002).

Mutual funds are the fastest growing segment of the financial services sector in India. During the last year, the assets managed by the industry have grown from Rs87,000 crores to Rs 1.55 lakh crores. The Rs87,000 figure itself is significant, since in the previous year the Unit Trust of India was split into two and Rs30,000 crores went out of the mutual funds industry along with the government-administered UTI-1.

The annual growth is expected to be between 30 and 35 per cent and on a growth phase. The penetration into semi-urban and rural areas is steadily increasing since more and more households are opting for mutual funds.

Keeping pace with the growth, a stringent regulatory framework has evolved. It started with the promulgation of the Mutual Fund Regulation Act 1993, amended in 1996, which lays down the regulatory framework and extensive operational details for the functioning of these funds.

The growth in mutual fund business is also accompanied by potential risks for the investors who invest in mutual fund schemes. The risks may be of different forms and due to different reasons.

3.3 RISKS IN MUTUAL FUND INVESTMENT:

The risks in mutual fund investments may arise due to the following:

i. Poor performance of the companies in which the mutual funds had invested the money collected from the investors. The poor performance may be due to mismanagement or misfortune of the company.

ii. Developments in the environment due to economic, political or other scenario. The developments will have impact resulting in the fall of the market. This will pull down the value of the investors holding in the fund.

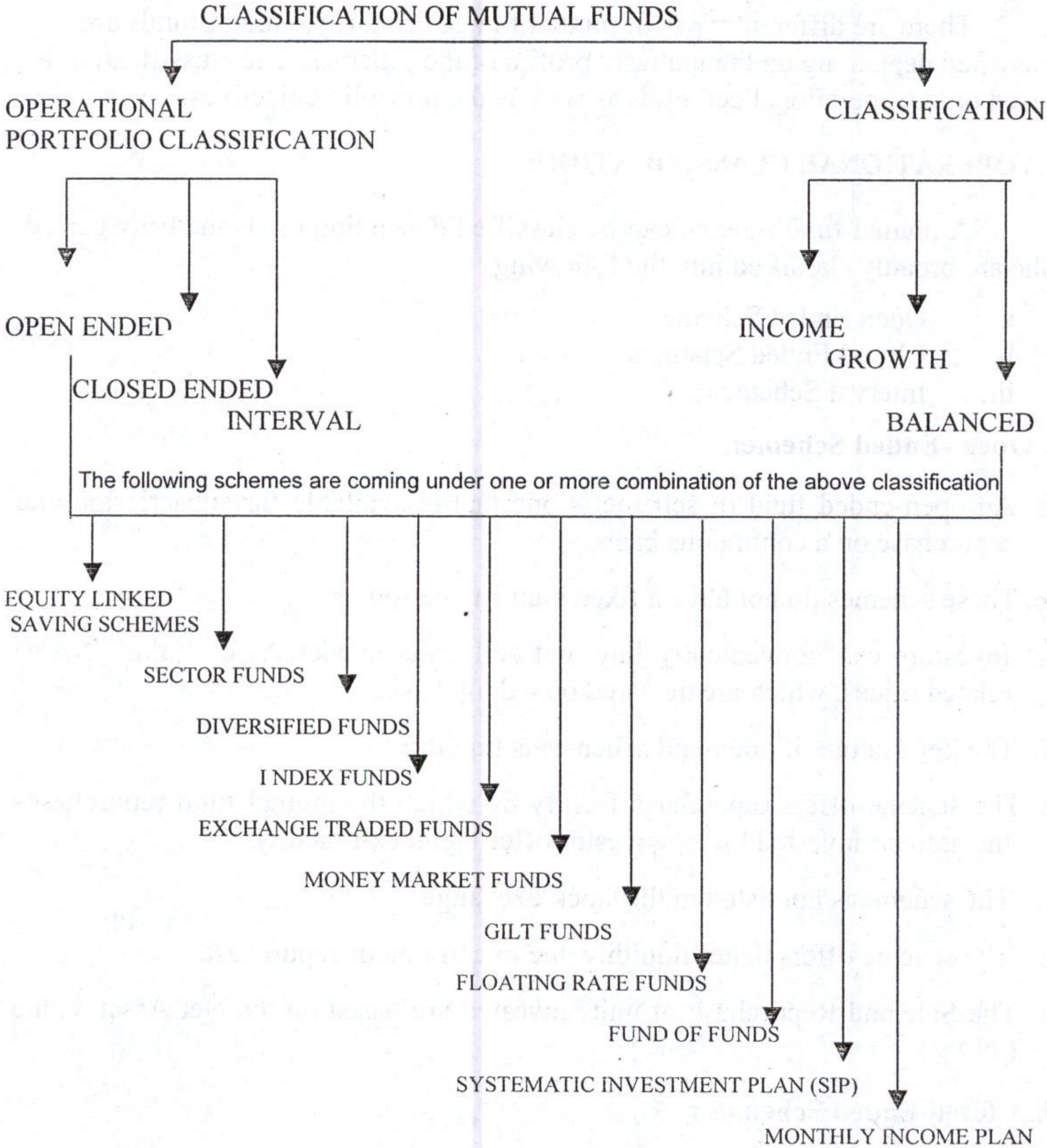
iii. Any wrong investment decisions by the mutual fund. The fund mangers of the mutual funds take a view for investment based on their research. Any wrong perceptions and resultant investments will result in a hit on the value and erosion in the investments.

3.4 ROLE OF AMFI

To obviate the risks for the investors investing in mutual funds, the Association of Mutual Funds of India (AMFI), created regulatory and disclosure norms for mutual funds. AMFI has structured standards and practices of professional and ethical conduct in every area starting from the wording of offer documents, disclosures, transparency, and valuations — the heart of mutual funds — to train intermediaries who are the sellers of mutual funds, and a code of conduct within which to operate.

The role of the AMFI is to set the standards in valuations, accounting, construction of NAVs, disclosures and guidelines for investment and limits to exposure in individual companies. The financial services sector functions on the basis of trust and confidence, and, confidence is best established through transparency, responsibility and ethical conduct, without exaggerated promises of appreciation or return. Protection to the investors' monies has to be ensured through policies, systems, practices and procedures being followed meticulously. Protection is ensured through internal controls and monitoring at three levels — the directors of the asset management company, the trustees of the funds who have fiduciary responsibility and SEBI to whom daily, weekly, fortnightly, monthly, quarterly and annual reports are provided. In view of the above the scope for willful misconduct becomes extremely difficult. Any error gets detected within a matter of days and remedial action initiated instead of being swept under the carpet. Due to stiff competition among the various mutual fund players, mutual funds now offer excellent array of products ranging from conventional products like growth and income schemes to sophisticated products like index funds, sector specific products to satisfy the varied needs of different investors. They also offer new generation products like exchange traded funds, which are funds, traded on the exchanges. Right now, an AMFI committee is exploring the possibility of funds to invest in commodity futures and capital guaranteed products. In the recent union budget, there is a provision for mutual funds to market gold funds. To sum up the mutual fund sector has a very interesting past, an encouraging present and a very bight future.

4.1 CLASSIFICATION OF MUTUAL FUND SCHEME



DIFFERENT TYPES OF MUTUAL FUND SCHEMES

There are different types of mutual funds. Primarily, mutual funds are classified depending on the maturity profile of the schemes. The classification is based on the operational activities as well as the portfolio objectives.

4.2 OPERATIONAL CLASSIFICATION:

A mutual fund scheme can be classified depending on its maturity period. The are broadly classified into the following :

i. Open Ended Schemes
ii. Closed Ended Schemes
iii. Interval Schemes

i. Open -Ended Scheme:

a. An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis.

b. These schemes do not have a fixed maturity period.

c. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices, which are declared on a daily basis.

d. The key feature of open-end schemes is liquidity.

e. The scheme offers repurchase facility by which the mutual fund repurchases the amount invested by the investor offering an exit facility.

f. The scheme is not listed in the stock exchange.

g. The scheme offers better liquidity due to continuous repurchase.

h. The Sale and Repurchase of units invested are based on the Net Asset Value (NAV)

ii. Closed Ended Schemes :

a. A close-ended fund or scheme has a stipulated maturity period e.g. 2-15years.

b. The fund is open for subscription only during a specified period at the time of launch of the scheme.

c. The corpus of the scheme (amount mobilsed by the scheme) normally does not change throughout the year

d. Such schemes are normally listed in the stock exchange.

e. Alternatively if not listed on the stock exchanges, repurchase facility is provided as an exit route. During the said period, mutual fund is ready to buy or sell the units directly from or to the investors at Net Asset Value(NAV) related prices.

f. Liquidity normally at the time of redemption.

g. Investment Strategies in the schemes are long term depending on the life of the scheme.

h. Market price may be below or above par. The market price of the units could vary from the NAV of the scheme on account of demand and supply situations, investors' expectations and other market factors. One of the characteristics of close ended mutual fund schemes is that they generally trade at discounts to the NAV; but closer to maturity the discount narrows.

i. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed.

j. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges.

k. Closed Ended funds disclose NAV generally on weekly basis.

iii. Interval Schemes:

a. Interval Schemes are basically closed ended schemes

b. The peculiar feature of an interval scheme is that every year for a specified period (interval) the scheme is made open and becomes open ended.

c. Prior to and such interval the scheme operates as a close-ended scheme.

4.3 INVESTMENT OR PORTFOLIO CLASSIFICATION

The other classification of mutual fund schemes is done mainly based on the investment or portfolio objectives.

A scheme can also be classified as follows base on the investment objectives:

i. Income scheme,

ii. Growth scheme,

iii. Balanced scheme

Such schemes may be **open-ended** or **close-ended** schemes as described earlier. The classification is done based on the type of investments made schemewise and also the investment objectives and the pattern of portfolio investment schemewise.

The portfolio classification of the mutual fund schemes are as follows:

4.3.1 INCOME SCHEMES

Income Schemes are ideal for investors who are averse to risk. The characteristics of income schemes are explained below:

(a) The income schemes are also called as Debt Oriented Schemes.

(b) Providing a regular and steady income to investors is the aim of income funds

(c) The corpus of the income schemes are generally invested in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments.

(d) Income Schemes are less risky compared to equity schemes and the funds are not affected because of fluctuations in equity markets.

(e) At the same time opportunities of capital appreciation are limited in such funds.

(f) The NAVs of income funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to

increase in the short run and vice versa. However, long term investors may not bother about these fluctuations.

(g) The objective of the scheme is to maximize the current income .

(h) Another feature of the scheme is the periodical income distribution.

(i) In Income Schemes the funds invest 85 % in Debt & 15% in stocks to achieve the main objective of Providing Regular Income

(j) The investments by income schemes are mostly in low risk securities.

In spite of the above , there are certain risks involved in income schemes. They are,

1. **Credit Risk**: Credit Risk is the risk of default by the issuer of the underlying securities invested by the Fund.

2. **Liquidity Risk:** Liquidity risk is a risk where at circumstances of extreme volatility the investments become illiquid.

3. **Inflation Risk:** Inflation Risk is a risk where erosion will happen in the value of securities due to inflation.

4.3.2 GROWTH SCHEMES

Growth schemes are also called as equity oriented schemes.

4.3.2.1 Salient features of growth schemes:

(a) The objective of Growth Schemes is to achieve capital appreciation over the medium to long term.

(b) The corpus of the scheme is invested in growth oriented securities.

(c) Growth schemes normally invest a major part of their corpus in equities.

(d) Growth Schemes have comparatively high risks as the corpus is invested in equities and subject to stock market fluctuations / volatilities.

(e) Growth Schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date.

(f) Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

(g) In growth schemes, the fund invests 85 % in stocks and 15% in Debts. To achieve the objective is to provide long term capital appreciation.

4.3.2.2 Advantages of growth schemes:

i) there are fair chances of appreciation over time.

ii) they offer better hedge against inflation

iii) growth funds have outperformed the other asset class over long term

iv) better than Gold, real estate: due to better liquidity and low transaction cost .

But growth funds are volatile in nature.

The reasons for the volatile nature of growth funds are:

i) due to the portfolio mix of the stocks

ii) depends on the degree of diversification in the fund

iii) extent to which the fund manager tries to hedge.

4.3.3 BALANCED SCHEMES

Balanced schemes are a judicious mix of income and growth schemes.

Features of the balanced schemes:

(a) The objective of the balanced schemes is to provide current income as well as capital appreciation.

(b) The corpus of the scheme is invested in Equity and Fixed Income securities in the proportion indicated as per the offer document.

(c) The fund invest 50-60 % in stocks & 40-50% in debt instruments. The main objective is to Provide long-term growth of Capital & Regular Income.

(d) Balanced Schemes are also affected because of fluctuations in share prices in the stock markets because of investments in equities. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

(e) Balanced Funds are appropriate for investors looking for moderate growth.

4.3.4 EQUTY LINKED SAVING SCHEMES (Tax Savings Schemes)

The objectives of equity linked savings schemes are to provide tax incentives; e.g. Equity Linked Saving Schemes under sec. 88 of Income Tax Act.

Salient Features:

(a) Tax Saving Schemes are schemes that offer tax rebates to the investors under specific provisions of the Income Tax Act, 1961 as the Government offers tax incentives for investment in specified avenues. e.g. Equity Linked Savings Schemes (ELSS).

(b) Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.

(c) Tax Savings Schemes invest 100% in stocks. The main objective is to provide Capital Appreciation. Units in this scheme are subject to lock in period of 3 years from the date of allotment and also rebate of 20% is allowed under section 88 of IT act.

Mutual Funds can be further classified into different types depending upon the overall objectives of the fund. Brief details of the various schemes are enumerated below:

4.3.5 SECTOR FUNDS

Salient Features:

(a) Sector Specific Funds are funds which Invest the corpus in securities of certain sector of the economy.

(b) The risk is confined to one particular sector. Example: Information Technology Funds – investing only in companies dealing in hardware, software and other related activities.

(c) These are the funds/schemes which invest in the securities ***of only those sectors or industries as specified in the offer documents***. e.g. Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc.

(d) The returns in these funds are dependent on the performance of the respective sectors/industries.

(e) Sector specific funds may give higher returns,

(f) Sector Specific Funds are more risky compared to diversified funds.

(g) The performance of the Sector funds depends on the cyclical nature of the sector and the performance of the different companies in the sector.

(h) In case of Sector Funds, investors need to keep a watch on the performance of those sectors/industries and must exit at an appropriate time. They may also seek advice of an expert.

(i) The fund invest 100% in individual sector stocks to achieve the main objective of providing growth of capital over a period of time.

4.3.6 DIVERSIFIED FUNDS

Salient Features:

a. Diversified Funds are funds in which investments are made in equities across various industries / sectors either large cap or small cap.

b. Diversified Funds are ideal for the investors seeking anpreciation over medium to long term.

4.3.7 INDEX FUNDS

Salient Features :

(a) Index Funds are funds whose objective is to match the performance of the stock market by tracking an Index that represents the overall market. The investment is in a diversified market index.

(b) Index Funds replicate the portfolio of a particular index such as the BSE Sensitive Index, S&P NSE 50 Index (Nifty), etc

(c) Index Funds schemes invest in the securities in the same weightage comprising of an index.

(d) In Index Funds, NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme.

(e) There are also exchange traded index funds launched by the mutual funds which are traded on the stock exchanges.

(f) Index funds are expected to provide a rate of return over time that will approximate or match, but not exceed, that of the market, which they are mirroring.

4.3.7 EXCHANGE TRADED FUNDS

Salient Features:

a. Exchange Traded Funds(ETF) are akin to index funds.

b. It matches with the index funds as ETFs also follow an index. For example the country's first ETF , Nifty Benchmark Exchange Traded Scheme (Nifty BeES) track the Nifty.

c. But it differs from an index fund in the sense that unlike an index fund which can be transacted only through the fund house at the following day's NAV, an ETF is listed on the stock exchanges.

d. ETFs can be bought and sold from the market at real time prices through a broker.

4.3.8 MONEY MARKET FUNDS

Salient Features :

(a) Money Market Funds are funds where investment is made in securities of short -term nature, which generally means securities of less than one- year maturity.

(b) Money Market Funds are also called as Liquid Funds.

(c) The main advantages of money market funds are the Liquidity and Safety of principal that the investors can normally expect from short-term investments.

(d) Money Market Funds are also called income funds and their aim is to provide easy liquidity, preservation of capital and moderate income.

(e) Schemes under this fund are classified as Cash/Liquid Fund and Bond Funds.

(f) Cash/Liquid Funds invest exclusively in safe short-term instruments such as Treasury Bills, Certificates of Deposits, Commercial Paper and Inter-Bank Call Money, Government Securities, etc.

(g) Bond Funds invest in medium to long term Bonds issued by corporate and governments.

(h) Money Market Schemes' returns fluctuate much less compared to other funds.

(i) Money Market Funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

(j) The fund invest 100% in Government and Public sector bonds, Money market instruments & Corporate debt. With the main objective of providing an attractive rate of return while emphasizing Capital preservation and liquidity

4.3.9 GILT FUNDS

Salient Features:

(a) Gilt Funds are funds where investment is made in Government Securities. Since the issuer is the Government of India / State, these funds have little risk of default as there is no credit risk involved.

(b) The fund invest 100% in State/Central Government securities to achieve main objective of providing risk free returns & Liquidity.

4.3.10 FLOATING RATE FUNDS

Salient Features :

(a) Floating rate funds are basically debt funds.

(b) Floating rate funds invest mainly in debt securities whose rates are flexible to accommodate changes in interest rates.

(c) The securities are marked to a benchmark rate like the G Sec (Government of India Securities) yield for a comparable tenor or the Mibor (Mumbai Inter Bank Offered Rate), plus a spread to compensate the buyer for the additional risk.

(d) Investment of the funds are mainly in corporate debt, securitised paper and asset backed securities.

(e) The interest rates on the above securities are aligned with the market.

(f) Most of the schemes invest in short duration securities as they are least sensitive to interest rate changes.

(g) Floating rate funds generate returns from the higher coupon rates (interest rate mentioned in the securities),unlike other debt schemes where the returns are generated by capital appreciation.

(h) Floating rate schemes are mainly focussed to obviate interest rate risk and the schemes offer the investors option for capital preservation.

4.3.11 FUND OF FUNDS

Salient Features :

a. Fund of Funds (FOF) mutual fund schemes are hybrid schemes that invest in other mutual fund schemes instead of investing in shares and debt securities.

b. The equity fund of fund schemes invests in equity schemes of other mutual fund schemes.

c. The debt fund of fund schemes invests in debt schemes of other mutual fund schemes.

d. A composite fund of fund schemes invests in both types of schemes.

e. The objective of a FOF scheme is to spread the risk of investment by investors across a larger set of schemes.

f. Greater diversification is achieved by investors in FOF schemes by investing in one scheme. Investment in one equity FOF scheme might spread the investment across 20-30 stocks. FOF schemes by investing in five equity schemes might effectively invested in more number of stocks (though most equity schemes will have investment exposure in some common stocks) thus spreading the risk.

g. FOF schemes tracks meticulously the entire universe of mutual funds thus relieving the investors the problem of scouting for best schemes around and staying invested.

4.3.12 .1 SYSTEMATIC INVESTMENT PLAN (SIP)

Salient Features:

(a) Systematic Investment Plan is a method of investing into the fund of investor's choice at regular intervals over defined time frame.

(b) This helps the investor to invest monthly, quarterly etc.

(c) Since the amount is invested regularly and it is constant, the investor is able to get more number of units in the falling market and fewer unit when the price is high.

(d) This will help the investor to smoothen out the market fluctuations and the investment will be at a low cost over a period. This strategy in investing is called "Rupee Cost Averaging".

4.3.12.2 SYSTEMATIC WITHDRAWAL ADVANTAGE PLAN (SWAP)

In systematic withdrawal plan, withdrawal of funds in done in a regular interval to benefit in the rising market and to reap the benefit out of average increase in the earnings.

4.3.13 MONTHLY INCOME PLAN

(a) Monthly Income Plans (MIP) are basically debt funds that assured monthly returns.

(b) MIPs are conservative balanced funds because they invest a small percentage in equities also.

(c) MIPs invest 10 to 30 % in equities. The objective of equity investment is to generate marginally higher returns then debt over a time period.

4.4 CLASSIFICATION BY CHARGES

4.4.1 Load Fund

A Load Fund is one that charges a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is Rs.10. If the entry as well as exit load charged is 1%, then the investors who buy would be required to pay Rs.10.10 and those who offer their units for repurchase to the mutual fund will get only Rs.9.90 per unit. The investors should take the loads into consideration while making investment as these affect their yields/returns. However, the investors should also consider the performance track record and service standards of the mutual

fund which are more important. Efficient funds may give higher returns in spite of loads.

4.4.2 No Load Fund

A no-load fund is one that does not charge for entry or exit. It means the investors can enter the fund/scheme at NAV and no additional charges are payable on purchase or sale of units.

4.5 CLASSIFICATION BY GEOGRAPHY

4.5.1 Domestic Mutual Fund Schemes

Domestic Mutual Fund Schemes are schemes launched with a view to mobilize savings of the citizens of the country.

4.5.2 Offshore Mutual Fund Schemes

Off Shore Mutual Fund Schemes are mutual fund schemes launched with a view to mobilize the savings of the foreign countries for the investments in local markets. Normally collected through the countries enjoying zero status. The aim is normally long- term capital growth by investing in local equities.

5. ADVANTAGES OF INVESTING IN MUTUAL FUNDS

Investments in Mutual Funds have lot of advantages over other investment schemes offered by other financial institutions. There are general benefits applicable to all mutual fund schemes and there are also special benefits available in open-ended schemes. We will discuss below the benefits in detail:

5.1 GENERAL ADVANTAGES

1. Safety

The amount collected under the mutual fund schemes are invested in rated Bonds & Blue chip Corporate equities, Central / State Govt. Securities. In this way the safety of the investments are enhanced.

2. Variety

Mutual funds offer variety of schemes to choose from. Again mutual funds offer different types of schemes to different investors to suit their different needs and risk appetites. It offers an opportunity to an investor to invest sums across a variety of schemes, both debt and equity. For example, an investor can invest his money in a Growth Fund (equity scheme) and Income Fund (debt scheme) depending on his risk appetite and thus create a balanced portfolio easily or simply just buy a Balanced Scheme.

3. Affordability

A mutual fund invests in a portfolio of assets, i.e. bonds, shares, etc. depending upon the investment objective of the scheme. An investor can buy in to a portfolio of equities with a relatively small amount, which would otherwise be extremely expensive. In this way it is possible for the investors to build a portfolio of investments through a mutual fund rather than investing directly in the stock market.

4. Diversification

Diversification is an investing strategy that can be neatly summed up as "Don't put all your eggs in one basket." Spreading investments across a wide range of companies and industry sectors can help lower your risk if a company or sector fails. Some investors find it easier to achieve diversification through ownership of mutual funds rather than through ownership of individual stocks or bonds.

Mutual Funds invest across different securities (stocks, bonds, money market instruments, real estate, fixed deposits etc.) and different sectors (auto, textile, information technology etc.). By this method of investment, the risk is spread and thereby reduced. Diversification adds to the stability of returns. For example during one period of time equities might underperform but bonds and money market instruments might do well enough to offset the effect of a slump in the equity markets. Similarly the information technology sector might be faring poorly but the steel, infrastructure, auto and textile sectors might do well and may protect your principal investment as well as help you meet your return objectives. The best mutual funds design their portfolios in such away that

individual investments will react differently to the same economic conditions. For example, economic conditions like a rise in interest rates may cause certain securities in a diversified portfolio to decrease in value. Other securities in the portfolio will respond to the same economic conditions by increasing in value. When a portfolio is balanced in this way, the value of the overall portfolio should gradually increase over time, even if some securities lose value.

5.Tax Benefits

Investments in Tax Savings Schemes of mutual funds offer tax benefits to the investors. In this way investors can save tax by investing in mutual funds.

6. Regulations

Securities Exchange Board of India (SEBI), the mutual funds regulator has clearly defined rules, which govern mutual funds. These rules relate to the formation, administration and management of mutual funds and also prescribe disclosure and accounting requirements. Such a high level of regulation seeks to protect the interest of investors.

7. Professional Management

Qualified investment professionals, who are backed by a dedicated investment research team, which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme, who seek to maximise returns and minimise risk monitor investor's money. When you buy in to a mutual fund, you are handing your money to an investment professional who has experience in making investment decisions. It is the Fund Manager's job to (a) find the best securities for the fund, given the fund's stated investment objectives; and (b) keep track of investments and changes in market conditions and adjust the mix of the portfolio, as and when required.

8.Switchover Facility

This is a facility offered by the mutual funds for their investors to switch over between the schemes subject to certain prescriptions. This gives a choice

for the investor to make a shift in their investment according to the needs of the situation.

9. Low Operating Costs

The operating costs for the investors will be very less compared to the direct investments made by them in stocks. Mutual fund expenses are often no more than 1.5 percent of investment. Expenses for Index Funds are less than that, because index funds are not actively managed. Instead, they automatically buy stock in companies that are listed on a specific index.

10.Convenience

Investing in a Mutual Fund reduces paperwork and helps to avoid many problems such as bad deliveries, delayed payments and unnecessary follow up with brokers and companies. Mutual Funds save the investor's time and make investing easy and convenient.

11. Return Potential

Over a medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

12.Transparency

You get regular information on the value of your investment in addition to disclosure on the specific investments made by your scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

13.Flexibility

Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, you can systematically invest or withdraw funds according to your needs and convenience.

5.2 ADVANTAGES OF OPEN-ENDED SCHEMES

1. Liquidity

In open-ended mutual funds, you can redeem all or part of your units any time you wish. Some schemes do have a lock-in period where an investor cannot return the units until the completion of such a lock-in period. Mutual fund

investors can readily redeem their shares at the current NAV — plus any fees and charges assessed on redemption at any time.

2. Convenience

An investor can purchase or sell fund units directly from a fund, through a broker or a financial planner. The investor may opt for a Systematic Investment Plan ("SIP") or a Systematic Withdrawal Advantage Plan ("SWAP"). In addition to this an investor receives account statements and portfolios of the schemes.

3. Flexibility

Mutual Funds offering multiple schemes allow investors to switch easily between various schemes. This flexibility gives the investor a convenient way to change the mix of his portfolio over time.

4. Transparency

Open-ended mutual funds disclose their Net Asset Value ("NAV") daily and the entire portfolio monthly. This level of transparency, where the investor himself sees the underlying assets bought with his money, is unmatched by any other financial instrument. Thus the investor is in the know of the quality of the portfolio and can invest further or redeem depending on the kind of the portfolio that has been constructed by the investment manager.

5. Reduction / Diversification of Risk

The funds collected by the mutual funds from the investors are invested across diverse industries, sectors and companies in different proportions according to the investment objectives. This effectively reduces the risk faced by the investors for the returns from the investments, as the risk is well diversified across sectors. When one investment is down another might be up. Diversifying the investment holdings reduces risk tremendously. Because mutual funds automatically diversify in a predetermined category of investments (i.e. - growth companies, low-grade corporate bonds, international small companies the risk is reduced.

In spite of the advantages, no mutual fund gives any assurance for the return from the schemes, as per SEBI guidelines. It is also due to the reason that

any investment has certain amount of risk like; Market volatility in case of investment in Equities, Credit risk / Interest risks in case of debt funds etc. However in the medium to long run there is always growth in the Mutual Fund schemes due to their wide and varied portfolio.

6. DISADVANTAGE OF INVESTING IN MUTUAL FUNDS

We have seen above the different advantages of investing in various mutual fund schemes. Though there are many advantages, there is also an other side. Like any other investment option, mutual funds also have certain disadvantages.. The disadvantages of investing in mutual fund schemes are listed below:

a. Risk of Losing Money

There is no guarantee for your investment or return. No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money. There are no assured returns in Mutual funds. The returns can be higher over a long period. In case any mutual fund wants to assure returns they can do so, by clearly expressing the safety net / safety cushion available equivalent to the amount assured and the source in place.

b. Fees and commissions

All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or "loads" to compensate brokers, financial consultants, or financial planners. Even if the investor don't use a broker or other financial adviser, the investor will pay a sales commission for buying shares in a Load Fund.

c. Taxes

During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If the fund makes a

profit on its sales, the investor will pay taxes on the income received, even if the investor reinvest the money.

d. Management risk:

Mutual Fund depends on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as hoped, as much money will not be made on your investment as you expected. The companies in which the fund has invested will perform poorly, suffer mismanagement or otherwise meet with misfortune. Some economic, political or other development will cause the overall market to fall, dragging down with it the holdings of your particular fund.

Wrong Investment Decision or speculative Decisions by the fund management will be a factor. For instance, the fund may be doing things the investors don't know about or wouldn't like if they do. What you think is a plain vanilla domestic equity-income fund might, in order to boost returns, invest in derivatives, invest overseas, or invest in growth companies that pay little or no dividend. In a downturn, you could be in for an unpleasant surprise. There is also the risk that the fund will under-perform a benchmark index, which means that management fees aren't buying any added value

The companies in which the fund has invested will perform poorly, suffer mismanagement or otherwise meet with misfortune.

Some economic, political or other development will cause the overall market to fall, dragging down with it the holdings of your particular fund.

e. Costs Despite Negative Returns

Investors must pay sales charges, annual fees, and other expenses regardless of how the fund performs. And, depending on the timing of their investment, investors may also have to pay taxes on any capital gains distribution they receive even if the fund went on to perform poorly after they bought shares.

f. Lack of Control

Investors typically cannot ascertain the exact make-up of a fund's portfolio at any given time, nor can they directly influence which securities the fund manager buys and sells or the timing of those trades.

g. Price Uncertainty

With an individual stock, you can obtain real-time (or close to real-time) pricing information with relative ease by checking financial websites or by calling your broker. You can also monitor how a stock's price changes from hour to hour — or even second to second. By contrast, with a mutual fund, the price at which you purchase or redeem shares will typically depend on the fund's NAV, which the fund might not calculate until many hours after you've placed your order. In general, mutual funds must calculate their NAV at least once every business day.

But in mutual fund investments, generally the advantages will out weigh the disadvantages. The investor will make a decent return because of the expertise for investment available in mutual funds. Investors should always balance the advantages and disadvantages and take a balanced decision for investment.

7. ROLE OF MUTUAL FUNDS IN THE DEVELOPMENT OF CAPITAL MARKETS AND THE ECONOMY

Mutual Funds channelise the savings from the public through different schemes. The mobilsed amounts are invested in different types of securities. The investments by different mutual funds is flowing into the various forms of financial instruments across the different financial markets viz., money market, debt market, capital market etc., thus strengthening the markets .It also helps to develop a strong capital market by the active participation of mutual funds. Thereby it helps and contributes to capital formation and the growth of the economy.

A Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. India has a burgeoning population of middle class now estimated around 300 million. A typical Indian middle class family can have liquid savings ranging from Rs.2 to Rs.10 Lacs today. Investments in Banks are liquid and safe, but with the falling rate of interest offered by Banks on Deposits, it is no longer attractive. At best a part can be saved in bank deposits, but what is the other sources of investment for the common man? Mutual Fund is the ready answer. Viewed in this sense globally India is one of

the best markets for Mutual Fund Business, so also for Insurance business. This is the reason that foreign companies compete with one another in setting up insurance and mutual fund business units in India. The sheer magnitude of the population of educated white-collar employees provides unlimited scope for development of Mutual Fund Business in India.

The alternative to mutual fund is direct investment by the investor in equities and bonds or corporate deposits. All investments whether in shares, debentures or deposits involve risk: share value may go down depending upon the performance of the company, the industry, state of capital markets and the economy; generally, however, longer the term, lesser the risk; companies may default in payment of interest/ principal on their debentures/bonds/deposits; the rate of interest on an investment may fall short of the rate of inflation reducing the purchasing power. While risk cannot be eliminated, skillful management can minimise risk. Mutual Funds help to reduce risk through diversification and professional management. The experience and expertise of Mutual Fund managers in selecting fundamentally sound securities and timing their purchases and sales help them to build a diversified portfolio that minimises risk and maximises returns.

Mutual Funds have been permitted by SEBI recently to do Portfolio Management Services for which the guidelines are yet to be published.

In general Mutual Funds are better alternative for bank deposits to the investors who can invest their money for a long term growth as well as short term like money market instruments. The investments are generally safe as the portfolio consists of wide varieties of stocks comprising various industries, the growth being different among different sectors. The investor should normally follow up the growth in the NAV, industry etc. through the Investor Relation Centers of mutual funds to have proper information in this regard. Mutual Funds cannot give personal portfolio advise to investors. It is only through the investment in the schemes of mutual funds an investor can benefit. However the investors are given the information about the fund, portfolio details, about the market conditions, etc. whenever they contact mutual fund offices personally.

If one were to compare the industry today with what was prevalent in the early 1990s, there has been an enormous change for the better.

And most of this is thanks to the private sector mutual funds industry, which is in many ways the predominant part of the industry today, accounting for 80 per cent of the assets as on June 30, 2004. The rest of the money is with the UTI Mutual Fund and other public sector funds.

If nothing else, the public today understands mutual funds and the risks associated with them better than before.

In the early 1990s, even though mutual funds were quite popular with investors due to the strong performance of a few schemes, there was a very fuzzy understanding of the concept of mutual funds. There was a perception gap between what investors thought mutual funds could do and what mutual funds could actually do. During this period, an atmosphere of exuberance prevailed and there were great expectations from mutual funds."

The entry of the private sector funds brought with it a larger dose of reality and better disclosure practices. The start (of private sector funds) was strong. There were good managements in place. The disclosure levels were high and there was higher transparency. In fact this is one of the continuing legacies of the private sector.

There has been progress in other areas, too. The mutual fund industry has evolved in many aspects in the last decade or so, be it in terms of product innovation, distribution reach, investor education or leveraging technology for enhancing service standards.

In product innovations, private sector funds – where there are a lot of foreign funds – have led the way. From providing plain vanilla products (like equity, income and liquid funds), players have launched products that responded to market and investor requirements, like asset allocation funds, dynamic asset allocation funds (based on market PE levels or Sensex levels), floating rate funds, short-term income plans and exchange traded funds (ETFs), among others.

Investor education did get a reasonable amount of priority, but not enough. Franklin Templeton, whose India investments were monitored initially by fund whiz Mark Mobius, was a path-breaker in introducing professional management and investor education, investing a lot in this area.

Mutual funds create a ripple effect creating positive impact across all sectors of the economy. It promotes savings and the moblised savings from investors are invested in capital, debt and money markets thus triggering financial and economic activity across sectors which in turn spur manufacturing, servicing, retail activity among the various sectors and creates capital formation, employment and development of the economy. It rewards the investors with return and capital appreciation which again is ploughed back as savings and the cycle goes on.

SUGGESTED QUESTIONS

1. What are mutual funds? Explain briefly the concept of mutual funds.
2. What are the four distinct phases of growth of mutual fund industry in India?
3. Explain briefly the working of mutual fund by a flow chart.
4. Briefly explain the risks in mutual fund investment
5. Explain the two major classifications of mutual funds
6. Explain in detail the features of open ended, closed ended and interval schemes
7. What is portfolio classification of mutual funds? Explain in detail the salient features of income, growth and balanced schemes?
8. Discuss the features of Equity Linked Savings Schemes and Sector Funds
9. What is an Index Fund? Explain its salient features.
10. What are Exchange Traded Funds, Money Market Funds and Gilt Funds?
11. Explain the features of Floating Rate Funds and Fund Of Funds?
12. Discuss in detail the advantages of investing in Mutual Funds?
13. What are the advantages of open ended schemes?
14. What are the disadvantages of investing in mutual funds?
15. How mutual funds contribute to the development of capital market and the economy?

UNIT 2

1.1 CONSTITUTION AND ORGANISATION OF MUTUAL FUNDS

The mutual fund sector in India is regulated by SEBI. Earlier, Reserve Bank of India (RBI) was responsible for regulating money market mutual funds (MMMFs), but even this responsibilities now rests with SEBI.

Reserve Bank of India, as regulator of banks, would need to authorize the commencement of mutual fund operations by a banking entity. Similarly, since it is the regulator of money supply economy, it has control in the over the money market. Measures that it announcers for the money market could impact mutual fund operations. but beyond this ,all regulation of mutual funds is by SEBI.

The guide lines applicable to mutual funds are set out in the SEBI (Mutual funds) Regulations, 1996 ("the regulations").SEBI has prescribed a legal structure with in built checks and balances in the form of independent agencies for the various critical roles, namely trusteeship, asset management, and custody of investments.

A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company (AMC) and custodian. SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme. However, Unit Trust of India (UTI) is not registered with SEBI (as on January 15, 2002).

The constitution and organisation of mutual funds can be seen from two ways :

1.Unit Trust of India

2. Mutual funds of public sector financial institutions.

1.2 Organisation Structure of the Unit Trust of India

Unit Trust of India (UTI), which has a structure different from the three tiered structure of other mutual funds in India was established by the Government of India to encourage private savings and investment.

It was formed under a special Act of Parliament, viz. The Unit Trust of India Act, 1963 as a corporate body. The promoter-sponsor of UTI is the Government of India through the Reserve Bank and Financial institutions. In the true sense however they were the only owners of the initial units of the UTI.

The UTI Act provides that the general superintendence, direction and management of the affairs and business of the Trust shall vest in a Board of Trustees which may exercise all `powers and do all acts and things which may be exercised or done by the Trust.

The Board of Trustees comprises nominees of the Central Government, RBI, IDBI, LIC SBI, participating financial institutions and an Executive Trustee to be appointed by IDBI

The UTI Act stipulates that there shall be an Executive Committee, which shall consist of The Chairman of the Board, Executive Trustee and two other Trustees. Subject to such general or special directions as the Board may from time to time give, the Executive Committee shall be competent to deal with any matter within the competence of the Board of Trustees. The Executive Committee in effect, performs the asset management functions.

The activities of the Executive Committee which itself comprises members of the Board of Trustees, are overseen by the Board of Trustees themselves. In matters involving public interest, the Central Government and the Reserve Bank of India have powers to give directions.

1.3 Difference between the management structure of UTI and Other Mutual Funds:

The management structure of UTI is distinct from the remaining mutual funds.

1) UTI is a statutory body corporate and not a Trust under the Indian Trusts Act like other mutual funds.

2) In UTI, there is no separate asset management company with a separate Board of directors of AMC to manage the schemes.

3) In UTI the functions of the Board of directors of AMC, and Trustees are combined in the Executive Committee and Board of UTI.

4) The Sponsors exist in the form of Government and IDBI, though they do not hold any equity in the Trustee Company or AMC for none exists.

1.4 Organisation Structure of Mutual Funds of Public Sector Banks

When the public sector banks were allowed to set up mutual funds, the first mutual fund was set up by the State Bank of India in 1987 prior to the establishment of SEBI. State Bank of India preferred to adopt the Trust route and set up the mutual fund as a Trust under the Indian Trust Act 1882. Other mutual funds followed suit and thus Trusts set up under the Indian Trusts Act came to be the adopted legal form of mutual funds in India. The author or Settlor of the Trust came to be Principal Trustee and also functioned as the fund manager.

These mutual funds combined the role of Trustee, fund manager and custodian in the sponsoring bank. There was little demarcation in the role and responsibilities and the structure was open to conflict of interests.

Other mutual funds that were set up later adopted the same pattern and thus, over time, Trusts set up under the Indian Trusts Act became the accepted legal form for establishment of Mutual Funds in India. The author or Settlor of the Trust became the principal Trustee and also functioned as the fund manager.

With the establishment of SEBI under the SEBI Act, 1992, mutual funds other than the UTI, were for the first time brought under the regulatory purview of SEBI. At that time, no special legislation similar to the UTI Act existed under which the mutual funds could be incorporated. Historically, SEBI found that mutual funds had been set up by public sector banks adopting the trust route because using the route of the Companies Act appeared to be more complex as it could have also led to multiple regulatory jurisdiction. Sufficient information is not available as to whether, at this stage, a rigorous examination of the advantages and disadvantages of the two alternative routes were undertaken or not. Nonetheless, the SEBI (Mutual Funds) Regulations provided for setting up of mutual funds as Trusts under the Indian Trusts Act of 1882. It may not be out of place to mention that the Indian Trusts Act of 1882 was enacted to govern private Trusts and envisaged a different manner of conduct and supervision of

operations. Quite clearly, it did not at that time take into account the nature of activities that will be involved in the functioning of mutual funds.

SEBI, while framing the Mutual Fund Regulations, gave a lot of consideration to two major factors, one, that mutual funds garner large moneys from the pubic for investment in a dynamic market place which require specialisation on the part of persons performing these functions. Secondly, there could arise potential conflicts of interest, which were to be avoided by ensuring arm's length relationship between various functionaries. Such stipulation of arm's length relationship ensures that the person who performs a function is answerable to another and does not assess or judge his own performance. The Regulations stipulated a three tiered structure of entities for carrying out different functions of a mutual fund, but placed the primary responsibility on the trustees. Internationally, irrespective of the route adopted, a three tiered structure exists and there is segregation between the responsibility of fund management and the trustee or supervisory responsibility.

Considering the inherent fiduciary nature of the functions, arm's length relationships were sought to be built into the various constituents of a mutual fund, primarily through separate entities and delineating the role and responsibility of the asset management companies and the Trustees and regulations on affiliate transactions. Arm's length relationships were also expected to be achieved by requiring a certain proportion of Trustees to be independent of the sponsor, requiring independent directors on the board of the AMC and requiring an independent custodian to be appointed. Following the notification of the SEBI (Mutual Funds), Regulations, 1993, SEBI gained further experience in administering the Mutual Funds Regulations and regulating the mutual fund industry.

A Conference of Chairman/Sponsors of the Board of Trustees of Mutual Funds was convened by SEBI in February 1997. This was to take note of the provisions/changes introduced through the SEBI (Mutual Funds) Regulations, 1996. At this conference, serious concern and reservations were expressed by various Trustees in regard to the liability and exposure of the trustees under the newly amended regulations and the expectations of SEBI about the role of the trustees. Particular concern was expressed about the lack of infrastructure support available with the trustees and its inconsistency with the nature of

performance now expected from them. The arrangements under which trustees were currently functioning were not of a nature that would enable them to discharge any of these heavy responsibilities. Fears were also expressed that they might even discourage persons with experience and of eminence from accepting such responsibilities. The Regulations require trustees to be persons of experience. The Regulations also require trustees to be persons of ability, integrity and standing. The expectation was that the association of such trustees would lend credibility to the Mutual Funds. At the Conference, it was pointed out that this imbalance needed to be carefully studied so that trustees are placed in a position to discharge the responsibilities and functions expected of them and are also simultaneously provided with infra-structure support and a working regime which enabled them to play an appropriate role in the Mutual Funds Industry. There should neither be over-expectation from an imperfect and imbalanced system nor any lowering of the role they are expected to play as monitors in the first instance.

Taking note of these observations, SEBI constituted a Committee under the Chairmanship of Mr.P.K.Kaul to recommend a work pattern, which would enable discharging of responsibilities by the trustees as envisaged under the Scheme and the Regulations.

The terms of reference of the P.K.Kaul Committee were:

a. to work out a model management information system particularly at asset management company (AMC) and Trustee levels as also the Reporting systems to SEBI·
b. to recommend necessary clarification regarding the manner of compliance of some of the provisions of the Regulations;
c. to look into the feasibility of organising mutual funds alternatively as companies and the applicability of the Indian Trusts Act vis-a-vis Trustees.

The Committee held several meetings and deliberated on all the provisions relevant to the role and responsibilities and liabilities of the Trustees under the Regulations and the Indian Trust Act and on the issues, which came up before SEBI in the course of administration of the Regulations. The Committee had the opportunity of discussing the principles and practices and the regulatory

framework governing the role of Trustees and independent directors of investment companies with particular reference to the mutual fund industry in the US. The Committee noted that in the US, the role of the board of directors of the Investment Company was central to policing the conflicts of interest inherent in the structure of mutual funds. As the mutual funds collect moneys from the public, the Committee acknowledged that the Trustees need to play the role of an "internal watch dog" in protecting the interests of the unit holders.

The Committee was seized with the task of allaying the concerns of Trustees in regard to the true scope of he Regulations while at the same time ensuring the due role of Trustees in exercising checks and balances.

It is seen on a broad overview of the 1996 Regulations framed by SEBI, that the rights, duties and obligations of all these constituents of a Mutual Fund need further codification. It is clear that the Regulations visualise that there are basic requirements before a person can be a sponsor of the Mutual Fund. To quote, the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions. There are similar threshold expectations in respect of the Trustees and Asset Management Company and Custodian. It would, therefore, be eminently desirable that all these matters are codified under a single statute under which Mutual Funds can be constituted as corporate bodies. This will ensure establishing Mutual Funds on a permanent basis like companies and enable the law to clearly and unequivocally set out the rights, duties and obligations of the various constituents. On enactment of such a law as an Act of Parliament, the various constituents would clearly be aware of their rights, duties and obligations and likewise the unit-holders and regulatory authorities would also know what can be expected of the various constituents. There would also be progressive evolution of practice of accountability, disclosures and governance as in the case of corporate entities. Pending the enactment of the separate statute there was need to selectively modify the 1996 regulations to address the various concerns that were expressed by Trustees to SEBI.

The Report of the Committee was presented in two parts during May 1998. The first part outlines the structure of the Mutual Funds as envisaged under the SEBI (Mutual Funds) Regulations, 1996. The specific obligations of Trustees under the Regulations, provisions of the Indian Trusts Act and the

international experience are given in the second part. Annexure1 to the Report is 1615 a compilation of the role of the sponsor, obligations of the AMC and the responsibilities of the Trustees as provided in the Regulations. Annexure 2 discusses the suggested manner of discharging the obligations by the Trustees. Annexure 3 contains the model of the MIS checklist that may be furnished by AMC to the Trustees. Annexure 4 is a model reporting format of report to be furnished by the Trustees to SEBI.

The recommendations were incorporated in the SEBI (Mutual Fund) Regulations 1996 through amendments carried out in the year 1998. The mutual fund Industry is bound grow enormously rivaling the Banking and Insurance set up.

SEBI, based on the discussions held with the representatives of AMFI (Association of Mutual Funds of India) and in light of the regulatory experience gained prepared the "Mutual Funds 2000" Report which recommended certain changes in the Regulations. The revised Regulations of 1996 also sought to address the concerns expressed in various quarters regarding the functioning of the mutual funds and effectiveness of the Board of Directors of the AMC, the role of independent directors and also sought to impose further checks and balances on the board of directors of the AMC under the overall supervision of the Trustees and additional obligations on the Trustees. The genesis of these obligations lies in the principle that Trustees of a mutual fund are the first level regulators. The Regulations have laid great emphasis on strengthening the Trusteeship function by providing specific responsibilities on the Trustees and conferring greater powers to the Board of Trustees for improving the governance of the mutual funds. It has sought to enhance the level of supervision over the functioning of the funds and asset management companies by the Trustees inter alia by stipulating periodical review of the activities of the AMC by the Trustees, reporting by the AMC to the Trustees and by the Trustees to SEBI.

In the backdrop of the above we will discuss below the organisation structure of the mutual funds in general.

1.5.ORGANISATION OF MUTUAL FUNDS

Mutual funds can be organised in **two ways.**

The first one is the **Trust structure** and the second is the **Company structure.**

In both these structures, there is an entity, which undertakes the designing and marketing of schemes, raises money from the public under the schemes and manages the money on behalf of its owners.

The entity is the Asset Management Company (AMC) or fund manager.

To segregate the collected funds from this entity's own funds, the corpus is placed in a legal vehicle.

The character of the legal vehicle determines the character of the Fund itself.

If the vehicle is a corporate entity then the fund acquires the name of an investment company as in the US and UK .

If the entity is a Trust, the fund acquires the name of mutual fund as in UK and India, for example.

The important fundamental point irrespective of the structure is that in view of the fiduciary role of the AMC or the fund manager towards the public, there is a need for supervision of the activities of the AMC or fund manager by a separate body.

The supervisory role is fulfilled by the Board of Trustees and in a corporate structure by the Board of directors of the Investment Company.

2 .ORGANISATION STRUCTURE OF INDIAN MUTUAL FUNDS

There are four constituents of a mutual fund in India,

1. Sponsor,
2. Board of Trustees or Trustee company,
3. Asset management company and
4. Custodian.

Let us discuss in detail the salient features, requirements and responsibilities of the constituents.

2.1 SPONSOR

1. Sponsor is the Settler of the Trust, which holds Trust property on behalf of investors who are the beneficiaries of the Trust. The trust is established by a sponsor or more than one sponsor who is like promoter of a company.

2. Every project needs a promoter, a prime mover who has overall responsibility for the project. The promoter of mutual fund is referred to as a sponsor. As per the regulations sponsor means "any person who, acting alone or in combination with body corporate, establishes a mutual fund".
3. A sponsor has to meet the following qualifications prescribed by SEBI:
4. Sponsor should have a sound track record and general reputation of fairness and integrity in all business transactions.

Sound track record means:

(a) carrying in business in financial services for a period of not less than five years.

(b) having a profit, after providing for depreciation, interest and tax, in three out of the immediately preceding five years, including the fifth year.

(c) having a positive net worth in all the immediately preceding five years and in the immediately preceding year, having a net worth that is more than the capital contribution of the sponsor in the AMC.

(d) The sponsor has to contribute atleast 40 percent to the net worth of the AMC.

(e) Any person who holds 40 percent or more of the net worth of the AMC is deemed to be a sponsor and should therefore , meet all the qualifications prescribed for a sponsor.

(f) Sponsor should be a fit and proper person.

(g) Sponsors ,or any of its directors, or the principle officer to be employed by the mutual fund should not be guilty of fraud or convicted of an offense involving moral turpitude or found guilty any economic offense.

(h) While meeting the prescribed qualifications makes a person eligible to promote a mutual fund, the venture cannot be promoted unless SEBI permits it.

(i) Sponsor is also required to contribute at least 40% of the capital of the asset management company which is formed for managing the assets of the Trust.

The sponsor who establishes a Mutual Fund is similar to the author of a Trust. However, the author of a trust has a very limited role to play after settling a trust. But that is not the case in relation to the sponsor of a Mutual Fund who has a continuing interest in the Mutual Fund and whose credibility is significantly responsible for mobilising of savings of the public in a Mutual Fund.

2.2.1 Trustees:

The assets of the Trust comprise of properties of the schemes, which are floated by the Asset Management Company with the approval of the Trustees. The trustees of the mutual fund hold its property for the benefit of the unit holders.

1. A mutual fund has to be constituted in the form of a trust, created through a trust deed.

2. The trust deed has to contain certain clauses prescribed by SEBI and cannot contain any clause that

    a. limits or extinguishes the obligations and liabilities of the trust with respect the mutual fund or its investors;

    b. indemnifies the trustees or the AMC for loss or damage caused to the unit holders on account of negligence or acts of commission or omission;

    c. has to be duly registered under the provisions of the Indian Registration Act,1908 and

    d. has to be executed by the sponsor in favour of the trustees named in the deed.

Public trusts in India are governed by the Indian Trust Act 1882.

The Indian Trusts Act 1881gives two options for the constitution of trustees

i) An individual can be appointed as trustee. when more than one trustee is appointed, they would together constitute the Board of Trustees

ii) A company can be appointed as trustee. Such a trustee company, like any company under the Companies Act,1956, would have a Board of Directors.

Every trust has beneficiaries, namely the persons for whose benefit the trust has been created and trustees, namely the persons who are responsible for protecting the interest of beneficiaries.

When a trust is created for mutual fund operations, the beneficiaries are the investors who invest in the various schemes promoted by the mutual fund

2.2.2 Disqualifications for trustees

Given the critical role of trustees, the regulations provide stringent disqualifications .A person cannot be appointed trustee unless he/she is

(a) a person of ability , integrity and standing;

(b) has not been found guilty of moral turpitude and

(c) has not been convicted for any economic offence or violation of any securities laws

A person who does not suffer from these disqualifications is eligible to become a trustee in a mutual fund. But he/she can be appointed as a trustee only after the prior approval of SEBI

2.2.3 Governance

In order to strengthen the trusteeship and avoid potential conflicts of interest, it is provided that ;

1. Any mutual fund will have a minimum of four trustees.

2. Two thirds of the trustees need to be independent trustees, namely persons, who are associates of the sponsors, or associated with them in any manner whatsoever.

3. If consequent to an independent trustee vacating office, the number of independent trustees falls below the prescribed minimum, another independent trustee has to be appointed to fill the gap within three months.

4. Relatives(as defined in the Companies act)of the sponsor, directors of the sponsor company, are relatives of associate directors of the AMCs and trustees companies are considered to be "associate".

5. Similarly , nominees of companies who are stake holders in the sponsor company or AMC are considered to be "associate"

6. An asset management company, or any of its officers or employees are not eligible to act as trustee of any mutual fund.

7. No person who has been appointed of a mutual fund can be appointed as a trustee of any other mutual fund unless

   (a) the person is an independent trustee and

   (b) the mutual fund where she is already a trustee gives prior approval for the proposed appointment in the other mutual fund.

8. If a company is appointed as trustee, then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund.

9. A person who is an "associate" in accordance with definition in the Regulation cannot be appointed as independent director even after he/she ceases to be an "associate" unless a cooling of period of three years has elapsed from the date of her dissociation.

10. The quorum of any meeting of the trustees shall be deemed not to have been reached, unless at least one independent trustee/director is present.

11. The auditor for the mutual fund would be different from the auditor of the AMC.

2.2.4 Obligations of trustees

Some key obligations of trustees are as follows:

1. The trustees shall enter into an investment management agreement with the AMC
2. Before the launch of any scheme they shall ensure that the AMC has
   (a) systems in place for its back office, dealing room ,accounting
   (b) appointed all key personnel including fund managers.
   (c) appointed a compliance officer to comply with regulatory requirements and to redress investor grievances.
   (d) appointed auditors and registrars.
   (e) prepared a compliance manual and designed internal control mechanisms including internal audit and
   (f) specified norms for empanelment of brokers and marketing agents
3. They shall be accountable for , and be custodian of, the funds and property of the respective schemes and shall hold the same in trust for the benefit of the unit holders
4. Trustees shall ensure that all activities of the AMC are in accordance with the provisions of the SEBI regulations.
5. If they have reason to believe that the conduct of the business of the mutual fund is not in accordance with the regulations and the scheme, they shall take appropriate remedial steps and inform SEBI immediately.
6. Each trustee shall file the details of her transactions in securities with the mutual fund on a quarterly basis.
7. They shall meet atleast once every calendar month, and at least six such meetings shall be held every year.

2.2.5 The other operational obligations cast on the Trustees by the SEBI (Mutual Funds) Regulations, 1996 are;

1. calling for a report from the compliance department of AMC periodically;

2. calling for information from the AMC to satisfy itself that the AMC has not given any undue or unfair advantage to any affiliates, dealt with any of the affiliates of the AMC in any manner detrimental to the investors and not provided for in the Regulations;

3. reviewing all transactions with affiliates and payments made by the mutual fund to affiliates periodically;

4. calling from the AMC the information on the procedure for empanelment of brokers and satisfying itself that the AMC has taken adequate care in the choice of brokers, in monitoring and following up of transactions with brokers and avoiding undue concentration of business with brokers;

5. reviewing all service contracts such as custody arrangements or transfer agency of the securities periodically;

6. reviewing the investor grievances redressal mechanism periodically;

7. filing their own transaction details in securities on half yearly basis with SEBI;

8. calling for similar details in respect of the board of directors and key personnel of the AMC

9. Furnishing to SEBI a certificate on a half yearly basis stating that the Board of Trustees has examined these statements and has satisfied itself that there has been no instance of self dealing or front running by any of the directors of the Trustee company and the AMC, employees of the AMC and the Trustee company.

10. The trustees shall obtain the consent of the unit holders,

    a. whenever SEBI asks for it.

    b. whenever three fourth of the unit holders of any scheme ask for it

c. when the majority of the trustees decides to windup or prematurely redeem the units and

d. when there is a change in the fundamental attributes of any scheme or trust or fees and expenses payable or any other change that would modify the scheme or affect the interest of the unit holders is proposed

11. They shall call for the details of transactions in securities by the key personnel of the AMC

12. They shall review quarterly, all transactions between mutual fund ,AMC and its associates.

13. They shall periodically review the investor complaints received and their redressal by the AMC

14. They shall review quarterly, net worth of the AMC and ensure that any shortfall is made up

15. They shall abide by the prescribed code of conduct.

16. Every half-year the trustees shall furnish to SEBI.

a. A report on the activities of the mutual fund.

b. A certificate that they have satisfied themselves that there have been no instances of self dealing or front running by any of the trustees, directors, and key personnel of the AMC and

c. A certificate that the AMC has been managing the schemes independent of any other activities.

17. The independent trustees shall give their comments on the report recived from the AMC regarding investments by the mutual fund in the securities of group companies of the sponsor.

18 The trustees shall be discerning in the appointment of directors on the board of the AMC.

2.2.6 Rights of trustees

1. The trustees have the right to obtain from the AMC, such information, as they consider necessary to fulfil their obligations

2. A majority of the trustees has the right to terminate the appointed of an AMC. Any change in the appointment of the AMC is however, subject to prior approval of SEBI and the unit holders

3. The trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence honestly.

4. The rights, duties and obligations of Trustees under the Indian Trusts Act are well recognised and well settled by a law, which is in force for over a century. The Trustees are expected to discharge their duties as men of prudence with reasonable care, skill and diligence in respect of property entrusted to them as they would bestow upon their own property. There are stringent consequences for dereliction of duty and breach of trust. Given the savings of large sections of the public, which in turn requires the entrustment of management of those funds to an AMC, it would throw up a whole set of complications and issues. The position is further compounded by detailed regulations as under regulation 18 with 23 sub-regulations stipulating rights and obligations of the Trustees. Again, many of the Trustees are organised as trustee companies and therefore the individuals are on the Board of Directors of the Trustee Company whose conduct is regulated under the Companies Act. The inter-action and inter-play of the Indian Trusts Act, the Companies Act and the SEBI Regulations, 1996, creates great apprehension in the minds of Trustees.

2.3.1 Asset Management Company :

Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. AMCs manage the investment portfolio of schemes.

The role of the AMC is akin to that of Managers or Managing Agents. A role of this nature is hardly visualised under the Indian Trusts Act where the basic thrust is obligation attaching to ownership of property and arising out of

confidence reposed in the Trustees for the benefit of the beneficiaries. The Trust Act, therefore, does not adequately deal with management of trust property in the nature of a Mutual Fund.

It is obligatory for every mutual fund to have an AMC to manage the mutual fund and operate its schemes. The actual could be made either by the sponsor or if so authorized by the trust deed, the trustees.

The appointment can be terminated by a majority of the trustees or by 75 percent of the unit holders. Any change in the appointment of the AMC is however subject to prior approval of SEBI and the unit holders.

The income of AMC comes from the management fee it charges for managing various schemes. The management fee is calculated as a percentage of the net assets managed.

If the schemes corpus is upto Rs.100 crores, the management fee is 1.25 percent if the corpus for a year.

If the scheme's corpus is over Rs.100 crores, the fee is 1 percent of the corpus.

For example if an asset management company has two schemes with a corpus of Rs. 100 crores and Rs.300 crores, the AMC will earn Rs.4.25 crores(1.25+3) as fund management fee for the year.

If the AMC's expenses exceeds the income from management fees earned from its schemes, the balance has to be met by the sponsor.

In some countries there is the concept of performance based management fees.

2.3.2 Requirements and Qualifications for AMC :

The important qualifications and requirements for an AMC are mentioned in brief below :

1. The existing AMCs should have a sound track record and general reputation for fairness and integrity in transactions.

2. The AMC has to be a fit and proper person

3. The AMC should have a net worth of not less than Rs.10 crores.

4. The directors of the AMC need to be persons having adequate professional experience in finance and financial services related fields and shall not have been found guilty of moral turpitude or convicted of economic offence or violation of any securities laws.

5. Atleast 50 percent of the directors of the AMCs board shall not be associate of, or be associated in any manner with ,the sponsor or any of its subsidiaries or the trustees since these are independent directors. if there is a fall below the prescribed minimum of independent directors, the gap has to be filled up within three months.

6. The Chairman of the AMC shall not be a trustee of any mutual fund.

7. No appointment of a director of an AMC shall be made without the prior approval of the trustees.

8. No person who has been appointed as director of an AMC can be appointed as a director of any other AMC unless:

9. the person is an independent director and

10. the AMC where he/she is already a director approves the proposed appointment in the other AMC.

2.3.3. Functions of an Asset Management Company :

The functions of an Asset management Company are very broad covering right from

- designing of the schemes,
- getting approval of the schemes,
- marketing of the schemes,
- appointing registrar and transfer agents, bankers,

- mobilising funds through the schemes marketed,
- issue of unit certificates to the investors,
- making investments of the funds mobilised,
- managing the investments for optimising, maximising the returns as per the investment objectives through fund managers,
- maintaining accounts,
- declaration and communication of NAVs as per requirements,
- auditing of accounts,
- distribution of dividends,
- fulfillment of compliance requirements to the Sponsor, SEBI, Investors

The functions are discussed below:

1. Schemes for the mutual fund will be floated by the AMC only after approval of the trustees.
2. Investment Management Agreement would be executed between the AMC and the trustees.
3. The AMC will first draft the schemes of the mutual fund.
4. The AMC will prepare the offer document, which has to contain adequate disclosures to enable investors to make an informed investment decision. The offer document needs to be filed with the SEBI, which has a period of 21 working days to stipulate modifications. The AMC can issue the offer document after this period.
5. The schemes including the offer document, key information memorandum etc. would need to be approved by the trustees in writing.
6. The trustees will authorise the AMC to launch the schemes.
7. After approval by the trustees, the AMC will market the schemes.
8. The advertisements for marketing the schemes have to conform to the advertising code of SEBI regulations and have to be submitted to SEBI within 7 days from the date of issue.

9. AMC will put in place the guidelines for the empanelment of brokers for purchase and sale of securities by the mutual fund schemes and distributors who would distribute the schemes of the mutual fund.

10. After receiving subscriptions equivalent to the minimum amount specified in the offer document, the AMC will allot units to the subscribers on behalf of the mutual fund.

11. The AMC will issue unit certificates or statement of accounts specifying the number of units allotted to each applicant within 6 weeks of closure of its subscription list. Account statements provide details of transactions under the schemes and not proof of title. Unit certificates are proof of title.

12. The AMC will then start investing the funds as and when the monies come in. Since the AMC is liable for investors made before allotment, funds are generally parked in risk free avenues such as bank deposits, call money, T-Bills etc. until allotment.

13. The AMC has to invest in line with the investment objectives set out in the offer document, post allotment. The AMC should adhere to the following regulations:

    (a) In the first six months 100 percent of the corpus can be invested in the money market, irrespective of the investment objectives of the scheme.

    (b) The limit of investment in money market will go down from 100 percent in the first six months to 30 percent in the second six months and further down to 25 per cent in the third six months of the scheme. Thereafter the investment objectives need to be complied with. A closed ended scheme can hold 100 percent of its corpus in money market investments, during the six month period prior to scheduled termination of the scheme.

14. The AMC can handle the registrar and transfer (R&T) work in house or appoint a SEBI approved R&T agent.

15. If the AMC chooses to perform the R&T activity in house, then appropriate arrangements would need to be put in place.

16. The AMC will maintain proper books of accounts, records and documents for each scheme, which has to be preserved for a period of eight years.
17. The AMC will submit to the trustees, quarterly reports on its activities and compliance with the regulations.
18. The AMC shall furnish such information and documents to the trustees as and when required by them.
19. The AMC is responsible for any commission or omission of its employees and its other service providers.
20. The AMC will appoint statutory auditors who would audit the accounts of the company, as distinct from the schemes. For schemes, the trustees would appoint the statutory auditor for the mutual fund to audit the various schemes promoted by the mutual fund. The auditor of the AMC would need to be different from the auditor of the mutual fund.
21. The AMC will appoint a Compliance Officer, appoint key personnel including fund managers and set up systems for investment management , accounting ,internal audit etc.
22. An AMC shall not :
    a. Act as a trustee of any mutual fund.
    b. Undertake any other business activities except portfolio management services and advisory services to offshore funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis/(other activities).
    c. The other business activities are again subject to
        - the other activities not conflicting with the activities of the mutual fund,
        - SEBI being satisfied that the key personnel, systems, back office, bank and securities accounts of the other activities are segregated from the mutual fund activities and
        - The asset management company meeting the capital adequacy requirements, if any of each such activity.

- The asset management company meeting the capital adequacy requirements, if any of each such activity.

2.4 CUSTODIANS

The safe custody of assets of the Trust is entrusted to one or more custodians. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The mutual fund shall appoint a custodian to carry out the custodial services for the schemes of the fund and inform SEBI about the appointment within 15 days. The mutual fund shall enter into a custodial agreement with the custodian. The agreement, the service contract, terms and appointment with the custodian shall be after prior approval of the trustees. If the sponsor or its associates hold 50% or more of the voting rights of the share capital of the custodian or where 50% or more of the directors of the custodian represent the interest of the sponsor or its associates, then such custodian will not be appointed for a mutual fund constituted by the same sponsor or any of its associate or subsidiary company.

SUGGESTED QUESTIONS

1. Explain briefly the organisational structure of Unit Trust of India.
2. Explain the difference between the management structure of UTI and other mutual funds.
3. Discuss briefly the two ways by which mutual funds can be organized.
4. Who are the constituents of a mutual fund? Discuss briefly.
5. Write a note on the Sponsor of a mutual fund.
6. Write a note on the Trustees of a mutual fund.
7. What are the essentials of trusteeship for proper governance of mutual funds?
8. What are the key obligations of trustees of mutual funds?
9. What are the operational obligations of trustees ? Discuss in detail.
10. Briefly explain the rights of trustees.
11. Write a note on Asset Management Company.
12. What are the requirements and qualifications for Asset Management Company?
13. Explain elaborately the functions of an Asset Management Company?
14. Write a brief note on 'Custodian' of a mutual fund.

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UNIT 3

1. OPERATIONAL ACTIVITIES OF A MUTUAL FUND

Mutual fund operations in India are regulated by Securities and Exchange Board of India (SEBI) .The various operational activities are to be carried out according to the prescriptions and guidelines given by SEBI. The guidelines cover the entire gamut of operations from formation of the mutual fund , different operational aspects and requirements to winding up of mutual fund. The important operational activities are detailed below:

VARIOUS OPERATIONAL ASPECTS

1.1 Procedure for investing in a mutual fund scheme:

Mutual funds normally come out with an advertisement in newspapers publishing the date of launch of the new schemes. Investors can also contact the agents and distributors of mutual funds who are spread all over the country for necessary information and application forms. Forms can be deposited with mutual funds through the agents and distributors who provide such services. Now a days, the post offices and banks also distribute the units of mutual funds. However, the investors may please note that the mutual funds schemes being marketed by banks and post offices should not be taken as their own schemes and no assurance of returns is given by them. The only role of banks and post offices is to help in distribution of mutual funds schemes to the investors.

Investors should not be carried away by commission/gifts given by agents/distributors for investing in a particular scheme. On the other hand they must consider the track record of the mutual fund and should take objective decisions.

1.2 Provision for non-resident Indians (NRIs) to invest in mutual funds :

Yes, non-resident Indians can also invest in mutual funds. Necessary details in this respect are given in the offer documents of the schemes.

1.3 Quantum of investment in debt or equity oriented schemes :

An investor should take into account his risk taking capacity, age factor, financial position, etc. As already mentioned, the schemes invest in different

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type of securities as disclosed in the offer documents and offer different returns and risks. Investors may also consult financial experts before taking decisions. Agents and distributors may also help in this regard.

1.4 Procedure for filling up the application form of a mutual fund scheme:

An investor must mention clearly his name, address, number of units applied for and such other information as required in the application form. He must give his bank account number so as to avoid any fraudulent encashment of any cheque/draft issued by the mutual fund at a later date for the purpose of dividend or repurchase. Any changes in the address, bank account number, etc at a later date should be informed to the mutual fund immediately.

1.5 Requirements of offer document :

An abridged offer document, which contains very useful information, is required to be given to the prospective investor by the mutual fund. The application form for subscription to a scheme is an integral part of the offer document. SEBI has prescribed minimum disclosures in the offer document. An investor, before investing in a scheme, should carefully read the offer document. Due care must be given to portions relating to main features of the scheme, risk factors, initial issue expenses and recurring expenses to be charged to the scheme, entry or exit loads, sponsor's track record, educational qualification and work experience of key personnel including fund managers, performance of other schemes launched by the mutual fund in the past, pending litigations and penalties imposed, etc.

1.6 Dispatching of certificate or statement of account after investing in a mutual fund:

Mutual funds are required to despatch certificates or statements of accounts within six weeks from the date of closure of the initial subscription of the scheme. In case of close-ended schemes, the investors would get either a demand account statement or unit certificates as these are traded in the stock exchanges. In case of open-ended schemes, a statement of account is issued by the mutual fund within 30 days from the date of closure of initial public offer of the scheme. The procedure of repurchase is mentioned in the offer document.

1.7 Time Limit for transfer of units after purchase from stock markets in case of close-ended schemes:

According to SEBI Regulations, transfer of units is required to be done within thirty days from the date of lodgment of certificates with the mutual fund.

1.8 Time Limit to receive dividends/repurchase proceeds:

A mutual fund is required to despatch to the unit holders the dividend warrants within 30 days of the declaration of the dividend and the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase request made by the unit holder.

In case of failures to despatch the redemption/repurchase proceeds within the stipulated time period, Asset Management Company is liable to pay interest as specified by SEBI from time to time.

1.9 Changing the nature of the scheme from the one specified in the offer document:

It can be allowed. However, no change in the nature or terms of the scheme, known as fundamental attributes of the scheme e.g. structure, investment pattern, etc. can be carried out unless a written communication is sent to each unit holder and an advertisement is given in one English daily having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is situated. The unit holders have the right to exit the scheme at the prevailing NAV without any exit load if they do not want to continue with the scheme. The mutual funds are also required to follow similar procedure while converting the scheme form close-ended to open-ended scheme and in case of change in sponsor.

1.10 Information for investors to know about the changes, if any, which may occur in the mutual fund:

There may be changes from time to time in a mutual fund. The mutual funds are required to inform any material changes to their unit holders. Apart from it, many mutual funds send quarterly newsletters to their investors.

At present, offer documents are required to be revised and updated at least once in two years. In the meantime, new investors are informed about the material changes by way of addendum to the offer document till the time offer document is revised and reprinted.

1.11 Informing the performance of a mutual fund scheme:

The performance of a scheme is reflected in its net asset value (NAV) which is disclosed on daily basis in case of open-ended schemes and on weekly basis in case of close-ended schemes. The NAVs of mutual funds are required to be published in newspapers. The NAVs are also available on the web sites of mutual funds. All mutual funds are also required to put their NAVs on the web site of Association of Mutual Funds in India (AMFI) www.amfiindia.com and thus the investors can access NAVs of all mutual funds at one place

The mutual funds are also required to publish their performance in the form of half-yearly results which also include their returns/yields over a period of time i.e. last six months, 1 year, 3 years, 5 years and since inception of schemes. Investors can also look into other details like percentage of expenses of total assets as these have an affect on the yield and other useful information in the same half-yearly format.

The mutual funds are also required to send annual report or abridged annual report to the unit holders at the end of the year.

Various studies on mutual fund schemes including yields of different schemes are being published by the financial newspapers on a weekly basis. Apart from these, many research agencies also publish research reports on performance of mutual funds including the ranking of various schemes in terms of their performance. Investors should study these reports and keep themselves informed about the performance of various schemes of different mutual funds.

Investors can compare the performance of their schemes with those of other mutual funds under the same category. They can also compare the performance of equity oriented schemes with the benchmarks like BSE Sensitive Index, S&P CNX Nifty, etc.

On the basis of performance of the mutual funds, the investors should decide when to enter or exit from a mutual fund scheme.

1.12 Information about where the mutual fund scheme has invested money mobilised from the investors :

The mutual funds are required to disclose full portfolios of all of their schemes on half-yearly basis which are published in the newspapers. Some mutual funds send the portfolios to their unit holders.

The scheme portfolio shows investment made in each security i.e. equity, debentures, money market instruments, government securities, etc. and their quantity, market value and % to NAV. These portfolio statements also required to disclose illiquid securities in the portfolio, investment made in rated and unrated debt securities, non-performing assets (NPAs), etc.

Some of the mutual funds send newsletters to the unit holders on quarterly basis which also contain portfolios of the schemes.

1.13 Information about change in asset allocation of schemes :

Considering the market trends, any prudent fund manager can change the asset allocation i.e. he can invest higher or lower percentage of the fund in equity or debt instruments compared to what is disclosed in the offer document. It can be done on a short-term basis on defensive considerations i.e. to protect the NAV. Hence the fund managers are allowed certain flexibility in altering the asset allocation considering the interest of the investors. In case the mutual fund wants to change the asset allocation on a permanent basis, they are required to inform the unit holders and giving them option to exit the scheme at prevailing NAV without any load.

1.14 Difference between investing in a mutual fund and in an initial public offering (IPO) of a company :

IPOs of companies may open at lower or higher price than the issue price depending on market sentiment and perception of investors. However, in the case of mutual funds, the par value of the units may not rise or fall immediately after allotment. A mutual fund scheme takes some time to make investment in

securities. NAV of the scheme depends on the value of securities in which the funds have been deployed.

1.15 Relevance of choosing schemes with lower NAV in the same category of different mutual funds :

Some of the investors have the tendency to prefer a scheme that is available at lower NAV compared to the one available at higher NAV. Sometimes, they prefer a new scheme which is issuing units at Rs. 10 whereas the existing schemes in the same category are available at much higher NAVs. Investors may please note that in case of mutual funds schemes, lower or higher NAVs of similar type schemes of different mutual funds have no relevance. On the other hand, investors should choose a scheme based on its merit considering performance track record of the mutual fund, service standards, professional management, etc. This is explained in an example given below.

Suppose scheme A is available at a NAV of Rs.15 and another scheme B at Rs.90. Both schemes are diversified equity oriented schemes. Investor has put Rs. 9,000 in each of the two schemes. He would get 600 units (9000/15) in scheme A and 100 units (9000/90) in scheme B. Assuming that the markets go up by 10 per cent and both the schemes perform equally good and it is reflected in their NAVs. NAV of scheme A would go up to Rs. 16.50 and that of scheme B to Rs. 99. Thus, the market value of investments would be Rs. 9,900 (600* 16.50) in scheme A and it would be the same amount of Rs. 9900 in scheme B (100*99). The investor would get the same return of 10% on his investment in each of the schemes. Thus, lower or higher NAV of the schemes and allotment of higher or lower number of units within the amount an investor is willing to invest, should not be the factors for making investment decision. Likewise, if a new equity oriented scheme is being offered at Rs.10 and an existing scheme is available for Rs. 90, should not be a factor for decision making by the investor. Similar is the case with income or debt-oriented schemes.

On the other hand, it is likely that the better managed scheme with higher NAV may give higher returns compared to a scheme which is available at lower NAV but is not managed efficiently. Similar is the case of fall in NAVs. Efficiently managed scheme at higher NAV may not fall as much as inefficiently managed scheme with lower NAV. Therefore, the investor should give more

weightage to the professional management of a scheme instead of lower NAV of any scheme. He may get much higher number of units at lower NAV, but the scheme may not give higher returns if it is not managed efficiently.

1.16 Method to choose a scheme for investment from a number of schemes available :

As already mentioned, the investors must read the offer document of the mutual fund scheme very carefully. They may also look into the past track record of performance of the scheme or other schemes of the same mutual fund. They may also compare the performance with other schemes having similar investment objectives. Though past performance of a scheme is not an indicator of its future performance and good performance in the past may or may not be sustained in the future, this is one of the important factors for making investment decision. In case of debt oriented schemes, apart from looking into past returns, the investors should also see the quality of debt instruments which is reflected in their rating. A scheme with lower rate of return but having investments in better-rated instruments may be safer. Similarly, in equities schemes also, investors may look for quality of portfolio. They may also seek advice of experts.

1.17 Difference between companies having names like mutual benefit and mutual funds schemes:

Investors should not assume some companies having the name "mutual benefit" as mutual funds. These companies do not come under the purview of SEBI. On the other hand, mutual funds can mobilise funds from the investors by launching schemes only after getting registered with SEBI as mutual funds.

1.18 Relevance of higher net worth of the sponsor as guarantee for better returns :

In the offer document of any mutual fund scheme, financial performance including the net worth of the sponsor for a period of three years is required to be given. The only purpose is that the investors should know the track record of the company which has sponsored the mutual fund. However, higher net worth of the sponsor does not mean that the scheme would give better returns or the sponsor would compensate in case the NAV falls.

1.19 Place where investor look out for information on mutual funds :

Almost all the mutual funds have their own web sites. Investors can also access the NAVs, half-yearly results and portfolios of all mutual funds at the web site of Association of mutual funds in India (AMFI) www.amfiindia.com. AMFI has also published useful literature for the investors.

Investors can log on to the web site of SEBI www.sebi.gov.in and go to "Mutual Funds" section for information on SEBI regulations and guidelines, data on mutual funds, draft offer documents filed by mutual funds, addresses of mutual funds, etc. Also, in the annual reports of SEBI available on the web site, a lot of information on mutual funds is given.

There are a number of other web sites which give a lot of information of various schemes of mutual funds including yields over a period of time. Many newspapers also publish useful information on mutual funds on daily and weekly basis. Investors may approach their agents and distributors to guide them in this regard.

1.20 Impact of winding up of mutual fund scheme on money invested:

In case of winding up of a scheme, the mutual funds pay a sum based on prevailing NAV after adjustment of expenses. Unit holders are entitled to receive a report on winding up from the mutual funds which gives all necessary details.

1.21 Investors complaint redressal mechanism:

Investors would find the name of contact person in the offer document of the mutual fund scheme that they may approach in case of any query, complaints or grievances. Trustees of a mutual fund monitor the activities of the mutual fund. The names of the directors of asset management company and trustees are also given in the offer documents. Investors can also approach SEBI for redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with them till the matter is resolved. Investors may send their complaints to: Securities and Exchange Board of India, Mutual Funds Department, Mittal Court 'B' wing, First Floor, 224, Nariman Point, Mumbai – 400 021. Phone: 2850451-56, 2880962-70

2. MUTUAL FUND MARKETING

Mutual funds collect money from investors and invest them under different schemes designed by them. The underlying objective for designing of different schemes (open ended, closed ended, income, growth, balanced, sector focussed, midcap and hybrid and what not?) and marketing them is primarily to make the customers subscribe to the schemes and enhance the value of their investments.

The mutual fund marketing has its own uniqueness of selling nothing i.e selling with no assurance of definite benefit (return).The statement is slightly shocking but mutual fund marketing has a different perspective than other financial services marketing. The definition of marketing as the management process responsible for identifying, anticipating and satisfying customers' requirements profitably is slightly different for mutual funds in the sense that the profit (return) is uncertain. In other financial products like bank deposits, the return to the depositors is known to the customer at the time of availing the product. Even in floating rate deposits where the rates are refixed periodically based on some benchmark rates, the return component is uncertain. But in mutual fund products, no assurance is normally given. The customer has to invest based on his risk appetite, background of the fund, historical returns generated by the funds over a time period consistently, fund manager of the AMC and of course customers' view about the particular scheme.

If we look at the market size of the mutual fund industry in India, the need for formulating and implementing a well focussed marketing plan by the mutual funds will be highlighted.

While the Mutual Fund industry in India has seen dramatic improvements in quantity as well as quality of product and service offerings over the past decade, industry experts concede that the growth witnessed in the last 10 years was considerably below potential. The mutual fund Assets Under Management (AUM) have grown from about Rs.470 billion in March 1993 to Rs.1,540 billion in April 2004 (CAGR of 11.4 per cent). In the United States, as high as 22 per cent of the household financial assets are invested in mutual funds, which is only slightly less than the proportion of assets invested in bank deposits. Compared to this, the assets under management of the entire mutual fund industry in India are

less than half of the deposits held by one bank, SBI and constitute less than 11 per cent of the Rs.14,042 billion total deposits held by the Indian banking industry.

One of the primary reasons for this slow growth is the fact that mutual funds are a new concept in India, which need to be still understood by large sections of Indian investors. In this scenario, the mutual fund companies have the onerous responsibility of not just selling mutual fund products, but 'marketing' them correctly. In other words, mutual funds should understand the specific needs of different segments of investors and sell the right product to the right customer. If sales of mutual fund products are not tailored to investor needs, there is the danger of the investor getting disillusioned with the mutual funds in general and the tremendous growth promise of the industry getting nipped in the bud. One such mutual fund product, which disappointed investors due to the vagaries in the stock market, is the popular Monthly Income Plan or MIP.

SEBI has published the unit holding pattern in Indian mutual funds as on 31 March 2003 which is reproduced below:

2.1 MUTUAL FUNDS INDUSTRY - UNIT HOLDING PATTERN

From the data collected from the mutual funds, the following observations are arrived :

1. As on March 31, 2003 there are a total number of 1.6 crore investors accounts. (it is likely that there may be more than one folio of an investor which might have been counted more than once and actual number of investors would be less) holding units of Rs. 79,601 crore. Out of this total number of investors accounts, 1.56 crore are individual investors accounts, accounting for 97.42% of the total number of investors accounts and contribute Rs.32,691 crore which is 41.07% of the total net assets. The total number of investors' account is lower in comparison with the total number of investors' accounts as on March 31, 2002 as the above data includes information only of UTI Mutual Fund (which is registered with SEBI on January 14, 2003). The data of the Specified Undertaking of UTI (not registered with SEBI) is not available with us.

2. Corporates and institutions who form only 2.04% of the total number of investors accounts in the mutual funds industry, contribute a sizeable amount of Rs.45,470 crore which is 57.12% of the total net assets in the mutual funds industry.

3. The NRIs / OCBs and FIIs constitute a very small percentage of investors accounts (0.54%) and contribute Rs.1440.18crore (1.81%) of net assets

The details of unit holding pattern are given in the following table:

Table I

UNITHOLDING PATTERN OF MUTUAL FUNDS INDUSTRY				
CATEGORY	NUMBER OF INVESTORS ACCOUNTS	% TO TOTAL INVESTORS ACCOUNTS	NET ASSET VALUE (RS.CRORE)	% TO TOTAL NET ASSET VALUE
Individuals	15,557,506	97.42	32,691.12	41.07
NRIs/OCBs	84,311	0.53	878.51	1.10
FIIs	2,058	0.01	561.67	0.71
Corporates/ Institutions/ Others	324,979	2.04	45,469.53	57.12
TOTAL	**15,968,854**	**100.00**	**79,600.83**	**100.00**

(Source: SEBI)

Note: Erstwhile UTI has been divided into UTI Mutual Fund (registered with SEBI) and the Specified Undertaking of UTI (not registered with SEBI). Above data contains information only of UTI Mutual Fund

2.2 UNITHOLDING PATTERN – PRIVATE/PUBLIC SECTOR MUTUAL FUNDS

From the analysis of data on unit holding pattern of Private Sector Mutual Funds and Public Sector Mutual Funds, the following observations are made:-

Out of a total of 1.6 crore investors accounts in the mutual funds industry, (it is likely that there may be more than one folio of an investor which might have been counted more than once and therefore actual number of investors may be less) 42.93 lakh investors accounts i.e 27% of the total investors accounts are in private sector mutual funds whereas the 1.17 crore investors accounts ie.73% are with the public sector mutual funds which includes UTI Mutual Fund. However, the private sector mutual funds manage 71.2% of the net assets whereas the public sector mutual funds own only 28.8% of the assets

UTI Mutual Fund has 97. 12 lakh investors accounts which is 60.82% of the total investors accounts in the mutual funds industry.

Details of unit holding pattern of private sector and public sector mutual funds are given in the following tables:

Table II

UNIT HOLDING PATTERN OF PRIVATE SECTOR MFS				
CATEGORY	NUMBER OF INVESTORS ACCOUNTS	% TO TOTAL INVESTORS ACCOUNTS	NET ASSET VALUE (RS.CRORE)	% TO TOTAL NET ASSET VALUE
Individuals	4001841	93.23	17956.48	31.68
NRIs/OCBs	38416	0.89	723.02	1.28
FIIs	1317	0.03	528.51	0.93
Corporates/Institutions/ Others	250972	5.85	37465.91	66.11
TOTAL	**4292546**	**100.00**	**56673.92**	**100.00**

(Source: SEBI)

Table III

UNITHOLDING PATTERN OF PUBLIC SECTOR MFS (INCLUDING UTI MF *)				
CATEGORY	NUMBER OF INVESTORS ACCOUNTS	% TO TOTAL INVESTORS ACCOUNTS	NET ASSET VALUE (RS.CRORE)	% TO TOTAL NET ASSET VALUE
Individuals	11,555,665	98.97	14734.64	64.27
NRIs/OCBs	45895	0.39	155.49	0.68
FIIs	741	0.01	33.16	0.14
Corporates/Insti-tutions/ Others	74007	0.63	8003.62	34.91
TOTAL	**11676308**	**100.00**	**22926.91**	**100.00**

(Source : SEBI)

Note: Erstwhile UTI has been divided into UTI Mutual Fund (registered with SEBI) and the Specified Undertaking of UTI (not registered with SEBI). Above data contains information only of UTI Mutual Fund.

Table IV

Scheme Categorywise Break Up Of Assets Under Management (AUM)

(In Rs.Billions)

Scheme Category	*Open End*	*Closed end*	*Total*	*% of Total*
Income	665.2	37.9	683.1	44.3
Liquid/Money Market	490.7	-	490.7	31.9
Gilt	62.0	-	62.0	4.00
Growth	231.8	14	245.8	16.0
Balanced	34.3	7.9	42.2	2.7
ELSS	5.1	11.4	16.5	1.1
Total	**1489.0**	**51.3**	**1540.2**	**100.00**

2.3 CUSTOMER SEGMENTS AND PREFERENCES OF MUTUAL FUNDS INDUSTRY

Analysis of the tables I to III throw some interesting facts about the customer segments and preferences of mutual fund industry. The following are the observations from the above tables:

1. Numberwise, the composition of individual unit holders or retail investors constitute a major percentage.
2. Businesswise, institutional investors contribute more than the retail investors.
3. The percentages of NRIs / OCBs ,FIIs are abysmally low when compared to retail and institutional investors.
4. In private sector mutual funds the business volume of institutional customers is more than double that of retail customers.
5. In public sector mutual funds, numberwise retail customers constitute the major force. The business volume the retail customers' contribute is almost double that of institutional customers.
6. In both the private and public sector mutual funds the investment by NRIs, OCBs and FIIs is almost negligible.
7. Table IV shows scheme-wise break-up of assets managed by mutual funds in India. The Indian mutual fund investor has so far displayed a clear inclination to be risk averse with over 80 per cent of the funds invested in Income, Money Market and Gilt schemes and only about 20 per cent in Growth and Balanced (a mix of Growth and Income) schemes.

2.4 CUSTOMER PROFILE OF MUTUAL FUNDS

The above analysis gives an idea of the customer profile of the mutual funds.

1. Retail customer segment's participation is more in public sector mutual funds than private sector mutual funds.

2. Similarly private sector mutual funds are able to attract more business from the institutional customers than retail customers.

The above clues give inputs for developing marketing strategies and marketing plans for mutual funds.

2.5 CHARACTERISTICS OF MUTUAL FUND MARKET IN INDIA:

The characteristics of Indian mutual fund market can be broadly explained as follows:

1. Indian mutual fund industry predominantly comprises of retail (individual) investors. People in service, business or profession and housewives are the important constituents of the retail investors.
2. Investors are basicallv risk averse more concentrating on safe schemes.
3. Investors prefer income cum growth schemes though equity schemes have also gained popularity.
4. Investors have significant preference for assured income schemes and schemes with insurance as a secondary benefit. This again highlights the safety preference of investors while investing in schemes.
5. The factors that trigger the investor for investing in mutual funds are past performance of the fund, reputation of the fund manager, service delivery effectiveness and the agents feedback to the investors about the schemes.
6. Investment decision is also influenced by the advertisements in newspapers and magazines.
7. Investors look for huge information from different sources for investment in schemes.

Mutual funds should take into account the above discussed factors for the designing , launching and marketing of mutual fund schemes. Taking the above into consideration and to exploit and translate the market potential into business, marketing plan of mutual funds inter alia should focus on the following factors:

2.6 FACTORS INFLUENCING MARKET ANALYSIS AND MARKETING PLAN OF MUTUAL FUNDS

Since mutual fund market are product driven, designing, pricing, distribution and promotion play a vital role for the success of products. Customer satisfaction along with attractive pricing will be the key drivers for success .Product related decisions must be made within the framework of economies of scale after considering the opportunities in the market, size and future business potential, customer expectations, competitive scenario etc.,

Mutual funds normally target household savings and the competition is cut throat. In this situation market analysis is a must for mutual funds and the market should be continuously scanned to tap the opportunities available in the market. In addition the operational costs and cost –price –value (benefits) relationship need to be analysed. This exercise is usually done in the pre launch stage. Since mutual funds' success depends on the savings market which again is linked to macro economic factors like the rate of savings, rates of growth of disposable income and household financial assets, marketing analysis should be linked to macro economic indicators.

The basic aim of mutual funds to do market analysis is to

i. reduce the risk of operation

ii. monitor marketing activities to control undesired development and

iii. to develop a sophisticated market intelligence mechanism.

The basic factors that contribute to the market analysis are detailed below :

i. Environmental Analysis

ii. Industry Analysis

iii. Company Analysis

iv. Customer Analysis

Let us discuss the factors in detail one by one.

2.6.1 Environmental Analysis

Environmental factors which are relevant are GDP, savings rate, growth of disposable income, fiscal parameters like monetary policy, fiscal policy, flow

of funds in the economy, money market, capital market, debt market etc.,. In
1617 addition to the above, socio political environment like expectations of investors, changes in economic behaviour and size of saving and spending.

2.6.2 Industry Analysis

The industry related factors that are to be analysed include:

1. Level of competition in the industry
2. Trends in the mutual fund industry
3. Perception about the industry
4. Competitive advantage of the industry like tax benefits Vis a Vis other savings instruments.
5. Level of customer satisfaction about the various alternative products.
6. Changes in the legal framework /regulatory framework governing the industry
7. Threat of emergence of new competing products.
8. Market imperfections which have an influence of investor confidence.
9. Product pricing in general
10. Changing customer preferences.

2.6.3 Company Analysis :

The company has to do a SWOT analysis (Strength / Weaknesses / Opportunities / Threats) to identify itself in the competitive scenario. The factors which are to be analysed by a company are :

1. Strengths of its products
2. Strengths of the competitive products
3. Advantages/Disadvantages of own and competitive products
4. Level of acceptance of new products by customers.
5. Product –Market Relationship
6. Market share of the company in the overall market

7. Introduction of new products based on history of acceptance levels.
8. Evaluation of price of new products
9. Evaluation of timing of new product launch
10. Customer Segmentation and identification of sectoral, geographical, incomewise target groups.
11. Evaluation of distribution methods
12. Comparative analysis of marketing, promotion and distribution costs vis a vis other funds.
13. Analysis of effectiveness of existing advertisement strategies.
14. Expected improvement in market share through additional launch of new products.
15. Evaluation of internal customers and their satisfaction levels across compensation factors like salaries, bonuses, other benefits, welfare and relationship measures.

2.6.4 Customer Analysis :

Customer is the fulcrum on which mutual funds are moving and no mutual fund can afford to ignore the customer. Customer analysis basically aims at to measure the customers' perception about the mutual fund in general and the products, price , benefits in particular. Mutual fund analyse the following in customer analysis.:

1. Preferences and expectations of customers
2. Due to change in the financial market scenario change in the preferences of customers and expected changes.
3. Customer grievance redressal and quality of after sales service.
4. Comparable service quality vis a vis other mutual funds
5. Changing loyalty factor of customers in the emerging competitive scenario with aggressive competition.

The above analysis will give structured and scientific inputs for designing, launching and marketing of schemes. Let us now list the essentials for a sound marketing plan and a pragmatic marketing strategy for mutual funds.

2.7 MARKETING PLAN FOR DESIGNING, LAUNCHING AND MARKETING OF SCHEMES

The marketing plan of a mutual fund hinges around the customer and the product –customer relationship. After being serviced by monopoly players for decades with hardly any choice in product offerings, the Indian consumer today is being wooed by virtually the Who's Who of global and Indian players with an unprecedented choice that was not available a decade back. In the face of cutthroat competition, mutual funds have to think of various marketing choices to survive and thrive in this highly promising industry. There has been a paradigm change in the quality and quantity of product and service offerings. A marketing plan and strategy will essentially be structured around the seven Ps of marketing viz., product, price, promotion, place, people, process and physical evidence.

2.7.1. Product :

(a) For the first three decades of the industry, from the setting up of UTI till the entry of private sector players, the only focus of the marketing strategy was different product offerings. UTI and various other public sector mutual funds focused on introducing an array of products falling in different categories. The categorisation was primarily based on two factors: one was the way the schemes were traded and the other through different composition of debt and equity securities in the scheme.

(b) Product differentiation was achieved by the composition of equity and debt in various schemes based on the schemes.

(c) In addition to the above, niche products (schemes) to fulfil specific needs, such as Tax Saving Schemes, Sector Specific Schemes, Index Schemes (which are passively invested in a benchmark Index) and so on.

(d) In the Product Focus stage, the aim of the mutual fund companies was to introduce a wide variety of products and due to oligopolistic competition;

there was no dearth of subscribers. The only parameter on which the selling was based was the relative performance of the products.

(e) In the present scenario, continuous product innovation and superior niche products creating 'niche out of niche' is the strategy followed by the mutual funds. For example, global opportunities funds (schemes which mainly invest in companies with a global perspective) will be an off shoot of technology funds which itself will be a niche fund investing in IT sector). In the competitive scenario, offering plain vanilla, scheme based products will attract lesser interest from investors than specialty products. The success of the mutual fund schemes will depend on the innovation level in the designing of the schemes .For example, the latest offering in mutual fund products is the mid cap fund floated by different mutual funds. The product is focussed as a highly attractive option for the investors highlighting that today's midcap companies are tomorrow's large cap companies and the growth prospects are huge and projecting that the return will be very attractive for the investors in these schemes.

(f) Different products cater to cater to different expectations of different customers like growth, income, liquidity, tax benefits etc., Product offerings should be aimed at satisfying one or more expectations of the investors.

(g) Product differentiation vis a vis competitive products is another key product related feature in marketing. Products that are competitive in nature to mutual fund products are all the assured return schemes like FDs, Relief Bond and Post Office MIPs. Hence MFs must differentiate primarily through returns, liquidity, convenience and diversification.

(h) Product launching is another important factor for marketing effectiveness. The timing of the launching of schemes will determine the success. For example schemes offering tax benefits should be launched at around the last quarter just near the end of the tax year when most of the prospects will be looking out for opportunities to invest in schemes with tax benefits to reduce their tax burden. Many Indian mutual funds have fared poorly due to wrong timing of launch. Market research and test marketing will help mutual funds to obviate this wrong timing in launching of schemes.

2.7.2 Price :

(a) The price of mutual fund products are intertwined with the returns. Indian mutual funds follow the policy of historic pricing structure. SEBI regulations prescribe the guidelines for pricing of units. The components of pricing are basically the sale price, the repurchase price, entry load and exit load. Sale price is the price at which the scheme is subscribed by the investors and the repurchase price is the price at which the mutual fund buy back the units at any given time. Entry load (front end load) is the charges to be paid by the investor at the time of subscription and exit load (back end load)is the charges to be paid by the investor at the time of redemption of units. Mutual funds publish the sale and repurchase price once in a week. Mutual funds have to ensure that the difference between sale and repurchase prices does not exceed 7 percent of the sale price. While finalising and deciding the price of units, other factors like incentives, brokerage, charges and commissions are also to be decided because these expenses will affect the ultimate returns to investors.

(b) Pricing also has the element of cost component for the AMCs which are charged to the mutual funds. The cost component includes investment, management and advisory fees and other initial expenses, which should not exceed 6 percent of the funds raised. The initial expenses include the issue cost of sponsoring the fund, recurring expenses like marketing, selling, agents' and brokers' commissions, transaction costs, registrar and transfer agents' fees, incentives to investors etc.,

(c) Loads are charges paid at the time of entry and exit by the investors. Mutual funds market schemes with 'load', 'no load' or 'partial load'. In partial load schemes, a part of the load shall be borne by the AMC and the rest by the scheme. In no load schemes, the initial expenses shall be borne by the AMC. Mutual funds use load as a marketing strategy to attract fund from investors by offering no load schemes waiving the entry load at the time of subscribing to the initial offer

2.7.3 Promotion:

(a) Promotion and distribution are the key elements for the marketing success of mutual funds. Appropriate distribution and promotion strategies will

ensure better acceptance of products by customers. Identification of appropriate market segments, selection of appropriate distribution channels and promotional aids are essential for the success of the schemes.

(b) Initially UTI schemes were sold through the LIC agents and the strategy was product focussed. The product focus continued for 2-3 years even after the entry of private sector players in 1993. Initially, the private sector companies introduced the same products available from the pubic sector players and promised superior performance. When they realised that they needed to differentiate on some other parameter as well, they focused on distribution. As it was difficult and time consuming to replicate the wide-spread distribution structure of Agents set up by UTI, they encouraged third-party distribution companies to distribute their products all over India. Specialist distribution companies such as Karvy, Bajaj Capital, Integrated Enterprises etc. had emerged. Special focus was given to investor servicing so that investors could experience superior servicing standards from private players. Some groups such as Birla Mutual Fund even set up their own distribution companies (Birla Distribution).

(c) While the focus on improved distribution and investor servicing did help the private players establish themselves against large players like UTI, it had also resulted in a lot of problems. In the rush to gain volumes and thereby commission incomes, the distribution companies many a time sold the wrong product to the wrong customer. A growth product, which invests primarily in risky instruments like equities was sold to old, retired people looking for regular, steady income as pension. This wrong approach paved the way for customer focussed distribution. The concept is discussed in the people element of marketing.

(d) Product promotion is done by mutual funds through advertisement and publicity. They issue advertisements through newspapers, television and other media. They conduct roadshows and set up stalls in prime locations and also offer incentives for subscriptions Mutual fund advertisements are regulated by SEBI which prohibits materials and contents of publicity which may mislead the investing public.

2.7.4 People :

(a) Mutual funds have to develop and implement proper people strategies for success of the schemes and satisfaction of the customers. Mutual fund companies began to segment their target customers and position their various products based on the target segment they proposed to address. It is common knowledge that right marketing involves proper segmentation of the market and targeting products designed to meet the specific needs of the chosen market segments. The common segmentation variables are geographic, demographic, psychographic (lifestyle, personality etc.) and behavioural (benefits, usage patterns, attitude etc.) At the broad level, the mutual fund market can be segmented based on risk appetite of the investor into risk averse and risk taking investor segments. In India, the risk averse segment is a much larger segment as is evidenced by the high and consistent demand for fixed income products. The risk averse segment can be further segmented based on specific benefits or needs such as regular income, children's education needs and so on.

(b) The target segment was broadly divided into institutional segment and individual investor segment. The institutional segment consisted of treasury departments of Corporates, Banks, Trusts etc and suitable products such as Institutional Income schemes and Money Market schemes were targeted at them. The individual investor was in turn divided into various segments such as Young Families with small or no children, Middle-aged People saving for retirement and Retired People looking for steady income. Suitable products such as Growth and Balanced schemes for young families and Income schemes for retired people were marketed.

(c) Segmentation based on psychographic profile is the most optimal basis of segmentation. However one cannot deny the usefulness of demographic/socio-economic segmentation while targeting certain products. When it comes to mass marketing or achieving economies of scale, psychographic profiles helps to identify the need/expectation of the customer and thus fill the gap in product portfolio by designing a new product. On the other hand, demographic/socio-economic segmentation helps in launching niche products and lowering expense ratios.

(d) By proper segmentation and by targeting the right product to the right customer, Mutual Fund companies hoped to win the confidence of their customers by successful people strategies.

2.7.5 Process :

(a) The process methodology and the process time are two important factors for customer satisfaction. The process method has to be simple and the process speedy enough not to create irritation in the minds of the customers.

(b) Servicing speed is another area where the fund houses have scored. Whatever the impetus, initiatives like settling transactions on a T+ 2 basis (against the Sebi norm of T+10), publishing daily NAVs, weekly and monthly updates on performance, online transactions, direct credit of sales proceeds and ATM withdrawals have benefited investors at all levels.

(c) Funds have been also quick to embrace technology by networking the various process centres and this has helped reduce the turnaround time for services like investments, redemptions and transfer, bringing them on a par with banks in turnaround time.

2.7.6 Place :

(a) This brings us to the all important question of the reach of the sector. The model for reaching the customer is multi pronged and has evolved and undergone rapid changes in the recent past. Customers are offered the place proposition in more than one way. The ways in which the customers are reached or the place where the customers can avail the products of mutual funds are

- through offices of mutual funds
- direct visits by marketing people in case of institutional sales
- Post Offices, Commercial Banks in case of retail business
- Distributors and Sub Brokers for retail business in non metro centres (B class and C class centres)
- Collection Centres run by the mutual funds.

(b) Banks as a place for selling mutual fund products is gaining strength in recent times. Almost all banks are in the mutual fund selling business as a value enhancer for their customers as well as to augment their non-fund business. Banks get commission for selling mutual fund schemes, which improves their fee-based income. The banking channel has come into distribution in a big way. Banks have far greater reach and have access to a huge customer base across the country to sell mutual fund schemes. Banks aggressively tie up with public and private sector mutual funds based on their business model for selling mutual fund schemes across the counter in different branches. But the success of the strategy depends on the willingness and attitude of the staff (internal customers) to sell an outsider's product to their customers. But how many of them are actually selling the products to retail or small investors is a big question. The biggest sales channel is still the financial products distributor.

2.7.7 Physical Evidence :

(a) Physical evidence is tangibilising the intangible. Since mutual fund schemes are financial products, no tangible product offering is possible and only the service offering is made. The only tangible part is the issue of unit certificates and with issuing units in the dematerialised (demat) format gaining ground and becoming a norm in the industry, physical evidence concept has got diluted still.

(b) Some of the tools that can be thought of is branding and brand building and developing brand equity. Branding helps the customer to identify himself with the product. Branding helps the investors to take a decision to buy the product if the branding matches his requirement.

(c) Selection of brand name and pricing is an important function of product development .Brand name highlights the market segments, inherent benefits and investment objectives and fosters brand loyalty.

(d) Brand identity is an important feature for product identification . Brand name should suggest the benefits of the scheme at the first instance itself. If the prospect is having doubts about the matching of brand name and his needs, he may not avail the product though the product may meet his requirement. Clarity of brand name (name of the scheme) for highlighting the features of

the schemes will immediately strike resonance in the customers' minds to make them avail the product.

(e) In the Indian mutual fund scenario, most of the products are linked to the name of the mutual funds. However with the entry of private players, naming of schemes or branding has assumed aggressive dimensions with brand names highlighting features and benefits and attracting prospects to initiate a purchase decision.

The above discussed factors are taken into consideration by mutual funds in varying degrees of importance based on the corporate objectives for designing, launching and marketing of mutual fund schemes.

3. INVESTMENT STRATEGIES AND PORTFOLIO MANAGEMENT

3.1 INVESTMENT STRATEGIES - IMPORTANT FEATURES

The main function of the mutual funds is to invest the mobilised funds under various schemes according to the scheme objectives and optimise the return to the investors. The investment policies of the funds are subject to the regulations of the SEBI

(a) The Asset Management Company shall take all reasonable steps and exercise all due diligence and ensure that the investment of funds under any schemes not contrary to the provisions and regulations of the trust deed.

(b) The trustee of a mutual fund must enter into an agreement with the Asset Management Company for investment of funds collected under the schemes.

(c) The AMC shall invest and manage the funds in accordance with the provisions of the trust deed and regulations.

(d) The AMC shall not invest and acquire any assets of the scheme property which may involve unlimited liability or may result in encumbrance of the scheme property in any way.

(e) The mutual fund may invest in any other scheme under the same AMC or any other mutual fund without charging fees provided that the aggregate interim investment by all schemes under the same management or in schemes under any other AMC shall not exceed 5 percent of the NAV of the mutual fund.

(f) No mutual fund under all its schemes should own more than10 per cent of any company's paid up capital carrying voting rights.

(g) The investment by mutual funds in buying and selling securities shall be on the basis of deliveries.

(h) Mutual funds are allowed to invest only in transferable securities in the money market, capital market and debt market.

(i) The investment of funds in different securities (capital, money market, debt market) will be based on the type of scheme.

(j) Asset allocation, portfolio diversification, portfolio readjustment within the limits set for the scheme are some of the measures of investment management followed by mutual funds.

(k) Asset allocation is basically allocating percentage of each asset class in the total portfolio. Asset allocation depends on the type of scheme and the composition of the scheme. For example, in growth funds, the asset allocation will be skewed more towards equity. In income funds , the asset allocation will be tilted towards fixed income securities. In balanced funds, the asset allocation will be a judicious mix of equity and fixed income securities. The choice of securities within the asset allocation will be based on research, market conditions, judgement and perception of the fund managers and the regulatory requirements.

3.2 PORTFOLIO MANAGEMENT - IMPORTANT FEATURES

(a) Portfolio turnover rate is considered to be an important aspect of investment management of mutual funds. For growth funds, the portfolio turnover will be higher. The rates of turnover are influenced by investment strategy and group oriented investment policy.

(b) The character of the portfolio has to be identified to decide the asset allocation strategy. Bogle (1994) characterised portfolio as complex managed, basic managed, tax minimising, simple managed, basic index, readymade convenience.

(c) A complex portfolio consist of growth, aggressive growth stocks and long and short term bonds, a readymade portfolio consist of index securities. A basic managed portfolio include a high percentage of value added stocks and bonds. A simple managed portfolio mainly consist of high grade blue chips. The important objective is to maximise the net returns.

(d) Diversification of portfolio is one of the mostly used methods to element the risk in investing. Diversification can take care of falling income, depreciation of capital and liquidity problem of the fund as a whole. However playing too much with diversification may rise the cost of funds and decrease in the rate of returns.

(e) A diversified portfolio calls for holding a variety of stocks across different industries to reduce risks due to fluctuation in markets and economic growth rate.

The portfolio should include

i. blue chip stocks-stocks of highest quality with a long record of earnings and dividend growth and industry leaders.

ii. emerging growth stocks-stocks of small companies engaged in developing new products, new technology, new service and have the potential to emerge as large profitable enterprises.

iii. cyclical stocks-stocks which are economy dependant and fortunes closely linked to the economy, and subject to accurate buying and selling to tide against the economic changes.

iv. Interest sensitive stocks-stocks which move inversely when interest rates rise and fall and which requires accurate forecasting of interest rates for making profits.

v. Utility stocks-defensive stocks not much influenced by economic fluctuations and give reasonable rate of returns as compared to bonds.

The above portfolio management measures are adopted by mutual funds to optimise the returns from the portfolio and to enhance mutual fund investors wealth.

SUGGESTED QUESTIONS

1. What is the procedure for investing in and filling up of an application form for mutual fund scheme?
2. Explain in detail the following:
   i) Time limit for dispatching certificate/statement of account
   ii) Time limit for transfer of units from stock market
   iii) Time limit to receive dividend/repurchase proceeds
3. Write a note on mutual fund marketing.
4. Explain in detail the customer segments and preferences, customer profile and characteristics of mutual fund market in India.
5. What is the basic aim of mutual funds to do market analysis? Discuss in detail the factors that contribute to the market analysis by mutual funds.
6. What are the marketing elements that are essential for structuring of marketing plan of mutual funds? Discuss the essentials of any three elements of marketing plan.
7. Discuss in detail any four marketing mix elements that are essential for structuring marketing plan of mutual funds.
8. Write a note on Place and Physical Evidence in marketing plan of mutual funds.
9. Write a note on Product and Price in marketing plan of mutual funds.
10. Discuss in detail the people, process and promotion elements of marketing plan of mutual funds.
11. Elaborate in detail the important features of investment strategies of mutual funds.
12. Write a note on the important features of portfolio management of mutual funds.

UNIT 4

1. REGULATION OF MUTUAL FUNDS

1.1 Mutual Fund Industry in India - Regulatory Measures by SEBI

The first mutual fund in India, Unit Trust of India functioned as a monopoly from its inception in 1964, which was diluted by the allowing of nationalised banks and insurance companies (both LIC and GIC) in the eighties. LIC & GIC set up their institutions under the Indian Trusts Act to transact mutual fund business, allowing the Indian Investor the option to choose between different service-providers. Unit Trust was a statutory corporation governed by its own incorporating Act. There was no separate Regulatory Authority upto the time SEBI was made a statutory authority in 1992. But it was only in the year 1993, when Government took a policy decision to deregulate Indian Economy from Government Control and to transform it market oriented, that the Industry was opened to competition from private and foreign players. SEBI initially formulated "SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1993" Providing detailed procedure for establishment, registration, constitution, management of Trustees, Asset Management Company, about schemes/products to be designed, about investment of funds collected, general obligation of MFs, about Inspection, audit etc. Based on experience gained and feedback received from the market SEBI revised the guidelines of 1993 and issued fresh Guidelines in 1996 titled "SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1996". The said regulations as amended from time to time is in force even today. The salient features of these regulatory measures are discussed in subsequent articles.

The Securities and Exchange Board of India issued the mutual fund regulations in December 1996 which repealed the mutual fund regulations issued in 1993.The regulations are comprehensive and outline the regulatory norms for the formation, operation and management of mutual funds. They also laid down the guidelines for investment valuations, investment restrictions, advertisement code and code of conduct for mutual funds and asset management companies.

1.2 THE SEBI MUTUAL FUND REGULATIONS CONTAIN TEN CHAPTERS AND TWELVE SCHEDULES

Chapters containing material subjects relating to regulation and conduct of business by Mutual Funds . Each chapter covers different operational guidelines with regard to mutual funds. The regulations cover the entire gamut of mutual fund management right from the requirements for starting a mutual fund to winding up of a mutual fund. The salient features of the regulation are detailed below:

Title : The regulations by SEBI for mutual funds are prescribed under the title SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1996.

Chapters: The regulations are codified into twelve chapters covering the different requirements.

The areas the various chapters cover are explained below :

Chapter I: Chapter 1 explains the legal terms and **preliminary requirements** for start ing a mutual fund .

Chapter II: Chapter II descries the requirements for **registration** of a mutual fund.

Chapter III: Chapter III explains the requirements for **Constitution and Management of Mutual Fund and Operation of Trustees etc.**

Chapter IV: Chapter IV details the prescriptions **for Constitution and Management of Asset Management Company and Custodian.**

Chapter V :Chapter V deals with the **schemes** of mutual funds.

Chapter VI : Chapter VI explains the **Investment Objectives and Valuation Policies** to be adopted by mutual funds.

Chapter VII: Chapter VII elaborates the **General Obligations.**

Chapter VIII: Chapter VIII relates the powers of SEBI for **Inspection and Audit** of mutual funds.

Chapter IX : Chapter IX deals with the offences and penalties and the procedure for **action in case of default**.

Chapter X: Chapter X deals with miscellaneous **schedules and forms.** The important forms and schedules are detailed subsequently.

Schedule I : Forms

Form A - Application for the Grant of Registration of Mutual Fund

Form B - Certificate of Registration

Form C - Trusteeship of The Mutual Fund

Form D - Asset Management Company

Schedule II: Fees

Schedule III: Contents of The Trust Deed

Schedule IV: Contents of The Investment Agreement

Schedule V: Code of Conduct

Schedule VI: Advertisement Code

Schedule VII: Restrictions on Investments

Schedule VIII: Investment Valuation Norms

Schedule IX: Accounting Policies and Standards

Schedule X: Initial Issue Expenses

Schedule XI: Annual Report

Schedule XII: Half Yearly Financial Results

1.3 THE IMPORTANT REGULATIONS AND THE CONTENTS OF THE ABOVE CHAPTERS ARE DISCUSSED IN DETAIL BELOW:

Chapter 2: Registering a Mutual Fund – Procedure :

Chapter 2 deals with the procedures for registering a mutual fund.

Every mutual fund shall be registered with SEBI.

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The application for registration for a mutual fund has to be made by the sponsor in the prescribed application form .The application should be accompanied of Rs.25000.

The criteria for registration are;

In case of existing mutual fund, the fund should be in the form of a trust and the trust deed should be approved by the board.

In the case of new fund to be set up, the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions.

The sponsor should have been doing business in financial services for not less than five years.

Net worth of the sponsor should be positive in all the immediately preceding five years.

The net worth of the immediately preceding year should be more than the capital contribution of the sponsor in the AMC.

The sponsor should show profits after providing depreciation, interest and tax for three out of the immediately preceding five years.

The sponsor should contribute atleast 40 % of the net worth of the AMC.

The sponsor and any of the directors or principal officer to be employed by the mutual fund should not have been found guilty or fraud or convicted of an offence involving moral turpitude or guilty of economic offences.

The fund should undertake for

a. appointment of trustees
b. AMC to manage the affairs of the .nutual fund
c. Custodian to keep custody of securities.

The application is examined and once the sponsor satisfies the prescribed eligibility criteria the registration certificate is issued.

The fees to be paid for registration is Rs.25.00 lacs.

The fund has to pay an annual service fees of Rs.2,50,000.

Regulation-9 Terms and Conditions for Registration

Regulation 9 deals with the terms and conditions for registration.

The registration granted to a mutual fund under regulation 9, shall be subject to the following terms and conditions:-

a. the trustees, the sponsor, the asset management company and the custodian shall comply with the provisions of these regulations;

b. the mutual fund shall forthwith inform the Board, if any information or particulars previously submitted to the Board was misleading or false in any material respect;

c. the mutual fund shall forthwith inform the Board, of any material change in the information or particulars previously furnished, which have a bearing on the registration granted by it;

d. payment of fees as specified in the regulations and the Second Schedule.(Rs.25 Lacs)

Regulation 14 - Constitution of the Mutual Fund

Regulation 14 deals with the constitution of mutual fund.

A mutual fund shall be constituted in the form of a trust

The instrument of trust shall be in the form of a deed, duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908) executed by the sponsor in favour of the trustees named in such an instrument.

Regulation 15 – Contents of the Trust Deed

The contents of the trust deed covered by Regulation 15 should be as follows :

1. The trust deed shall contain such clauses as are mentioned in the Third Schedule and such other clauses, which are necessary for safeguarding the interests of the unit holders.

2. No trust deed shall contain a clause which has the effect of-

i. limiting or extinguishing the obligations and liabilities of the trust in relation to any mutual fund or the unit holders; or

ii. indemnifying the trustees or the asset management company for loss or damage caused to the unit holders by their acts of negligence or acts of commissions or omissions.

Qualification prescribed for selection of persons as Trustees, Duties/Obligations of Trustees and Code of Conduct prescribed are discussed subsequently.

Trustees : Appointment ,Approval and Rights and Obligations of Trustees:

Regulation 16 - Appointment :

The eligibility criteria, duties &code of conduct for trustees are discussed in Regulation 16.

1. A mutual fund shall appoint trustees in accordance with the regulations.
2. A person shall be eligible to be appointed as a trustee if he
    a. is a person of ability, integrity and standing
    b. has not been found guilty of moral turpitude
    c. has not been convicted of any economic offence or violation of any securities laws; and
    d. has furnished particulars as specified in Form C (to the Schedule of the Regulations)
3. An asset management company or any of its officers or employees shall not be eligible to act as a trustee of any mutual fund.
4. No person who is appointed as a trustee of a mutual fund can be appointed as a trustee of any other mutual fund unless -
    a. such a person is an independent trustee and
    b. prior approval of the mutual fund of which he is a trustee has been obtained for such an appointment.
5. Two thirds of the trustees shall be independent persons and shall not be associated with the sponsors or be associated with them in any manner whatsoever.

6. In case a company is appointed as a trustee then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund.

Regulation 17 - Approval of the Board for Appointment of Trustee

The requirement for the approval of the of the board for appointment of trustees ins prescribed in Regulation 17

No trustee shall initially or any time thereafter be appointed without prior approval of the Board.

The existing trustees of any mutual fund may form a trustee company to act as a trustee with the prior approval of the Board.

Regulation 18 - Rights and Obligations of the Trustees

a. Rights and Obligations :

The rights and obligations of the trustees are discussed in Regulation 18 are detailed below:

1. The trustees and the asset management company shall with the prior approval of the Board enter into an investment management agreement.
2. The investment management agreement shall contain such clauses as are mentioned in the Fourth Schedule and such other clauses as are necessary for the purpose of making investments.
3. The trustees shall have a right to obtain from the asset management company such information as is considered necessary by the trustees.
4. The trustees shall ensure before the launch of any scheme that the asset management company has;-
    a. systems in place for its back office, dealing room and accounting;
    b. appointed all key personnel including fund manager(s) for the scheme(s) and submitted their bio-data which shall contain the educational qualifications, past experience in the securities market with the trustees, within 15 days of their appointment;

c. appointed auditors to audit its accounts;

d. appointed a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines instructions etc issued by the Board or the Central Government and for redressal of investors' grievances;

e. appointed registrars and laid down parameters for their supervision;

f. prepared a compliance manual and designed internal control mechanisms including internal audit systems;

g. specified norms for empanelment of brokers and marketing agents

5. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.

6. The trustees shall ensure that an asset management company has been diligent in empanelling the brokers, in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker.

7. The trustees shall ensure that the asset management company has not given any undue or unfair advantage to any associates or dealt with any of the associates of the asset management company in any manner detrimental to interest of the unit holders.

8. The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme.

9. The trustees shall ensure that the asset management company has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or of other activities of the asset management company.

10. The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations..

11. Where the trustees have reason to believe that the conduct of business of the mutual fund is not in accordance with these regulations and the scheme they shall forthwith take such remedial steps as are necessary by them and shall immediately inform the Board of the violation and the action taken by them.

12. Each trustee shall file the details of his transactions of dealing in securities with the Mutual Fund on a quarterly basis.

13. The trustees shall be accountable for, and be the custodian of, the funds and property of the respective schemes and shall hold the same in trust for the benefit of the unit holders in accordance with these regulations and the provisions of trust deed.

14. The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed.

15. The trustees shall be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the units of any scheme in accordance with these regulations and the trust deed.

16. The trustees shall obtain the consent of the unit holders -

    a. whenever required to do so by the Board in the interest of the unit-holders; or

    b. whenever required to do so on the requisition made by three-fourths of the unit holders of any scheme; or

    c. when the majority of the trustees decide to wind up or prematurely redeem the units; or

17. The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders, shall be carried out unless,

    i. a written communication about the proposed change is sent to each unit holder and an advertisement is given in one English daily

newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the Head Office of the mutual fund is situated; and

ii. the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load.

18. The trustees shall call for the details of transactions in securities by the key personnel of the asset management company in his own name or on behalf of the asset management company and shall report to the Board, as and when required.

19. The trustees shall quarterly review all transactions carried out between the mutual funds, asset management company and its associates.

20. The trustees shall quarterly review the net worth of the asset management company and in case of any shortfall, ensure that the asset management company make up for the shortfall.

21. The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy itself that such contracts are executed in the interest of the unit holders.

22. The trustees shall ensure that there is no conflict of interest between the manner of deployment of its net worth by the asset management company and the interest of the unit holders.

23. The trustees shall periodically review the investor complaints received and the redressal of the same by the asset management company.

24. The trustees shall abide by the Code of Conduct as specified in the Fifth Schedule

25. The trustees shall furnish to the Board on a half yearly basis, -

    a. a report on the activities of the mutual fund;

    b. a certificate stating that the trustees have satisfied themselves that there have been no instances of self dealing or front running by any of the trustees, directors and key personnel of the asset management company;

c. a certificate to the effect that the asset management company has been managing the schemes independently of any other activities and in case any activities of the nature referred to in sub-regulation (2) of regulation 24 have been undertaken by the asset management company and has taken adequate steps to ensure that the interest of the unit holders are protected.

26. The independent trustees shall give their comments on the report received from the asset management company regarding the investments by the mutual fund in the securities of group companies of the sponsor.

b. Due Diligence by Trustees :

Trustees shall exercise due diligence as under:

1. General Due Diligence:

1. the Trustees shall be discerning in the appointment of the directors on the Board of the asset management company.
2. Trustees shall review the desirability of continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.
3. The trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.
4. The trustee shall ensure that all service providers are holding appropriate registrations from the Board or concerned regulatory authority.
5. The Trustees shall arrange for test checks of service contracts.
6. Trustees shall immediately report to Board of any special developments in the mutual fund.

2. Specific Due Diligence:

The Trustees shall:

1. obtain internal audit reports at regular intervals from independent auditors appointed by the Trustees.
2. obtain compliance certificates at regular intervals from the asset management company.

3. hold meeting of trustees more frequently.
4. consider the reports of the independent auditor and compliance reports of asset management company at the meetings of trustees for appropriate action.
5. maintain records of the decisions of the Trustees at their meetings and of the minutes of the meetings.
6. prescribe and adhere to a code of ethics by the Trustees, asset management company and its personnel.
7. communicate in writing to the asset management company of the deficiencies and checking on the rectification of deficiencies.

Notwithstanding anything contained in sub-regulations (1) to (25), the trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence honestly.

c. Other Obligations :

The independent directors or the trustees or asset management company shall pay specific attention to the following, as may be applicable, namely:-

i. the Investment Management Agreement and the compensation paid under the agreement.
ii. service contracts with affiliates - whether the asset management company has charged higher fees than outside contractors for the same services.
iii. selection of the asset management company's independent directors
iv. securities transactions involving affiliates to the extent such transactions are permitted.
v. selecting and nominating individuals to fill independent directors vacancies.
vi. code of ethics must be designed to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions.

vii. the reasonableness of fees paid to sponsors, asset management company and any others for services provided.

viii. principal underwriting contracts and their renewals. Any service contract with the associates of the asset management company.

d. Code of Conduct :

CODE OF CONDUCT GOVERNING TRUSTEES & AMC OF MUTUAL FUNDS

The code of conduct for the trustees and AMC of mutual funds are discussed below:

1. Mutual fund schemes should not be organised, operated, managed or the portfolio of securities selected, in the interest of sponsors, directors of asset management companies, members of Board of trustees or directors of trustee company, associated persons as in the interest of special class of unit holders rather than in the interest of all classes of unit holders of the scheme.

2. Trustees and asset management companies must ensure the dissemination to all unit holders of adequate, accurate, explicit and timely information fairly presented in a simple language about the investment policies, investment objectives, financial position and general affairs of the scheme.

3. Trustees and asset management companies should avoid excessive concentration of business with broking firms, affiliates and also excessive holding of units in a scheme among a few investors.

4. Trustees and asset management companies must avoid conflicts of interest in managing the affairs of the schemes and keep the interest of all unit holders paramount in all matters.

5. Trustees and asset management companies must ensure schemewise segregation of bank accounts and securities accounts.

6. Trustees and asset management companies shall carry out the business and invest in accordance with the investment objectives stated in the offer

documents and take investment decision solely in the interest of unit holders.

7. Trustees and asset management companies must not use any unethical means to sell; market or induce any investor to buy their schemes.

8. Trustees and the asset management company shall maintain high standards of integrity and fairness in all their dealings and in the conduct of their business

9. Trustees and the asset management company shall render at all times high standards of service, .exercise due diligence, ensure proper care and exercise independent professional judgement.

10. The asset management company shall not make any exaggerated statement, whether oral or written, either about their qualifications or capability to render investment management services or their achievements].

11 a. The sponsor of the mutual fund, the trustees or the asset management company or any of their employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real - time or non real-time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice.>

b. In case, an employee of the sponsor, the trustees or the asset management company is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

Regulation 19 - Constitution and Management of Asset Management Company (AMC) and Custodian Application by an AMC

The constitution and management of Asset Management Company (AMC) and Custodian Application by an AMC are covered under Regulation 19.

The prescriptions under Regulation 19 are detailed below:

1. The application for the approval of the asset management company shall be made in Form D.

2. The provisions of regulations 5, 6 and 8 shall, so far as may be, apply to the application made under sub-regulation (1) as they apply to the application for registration of a mutual fund.

Regulation: 20, 21 - Appointment of an Asset Management Company

The eligibility criteria for appointment of Asset Management Company are prescribed under Regulation 20.The salient features of the regulation are detailed below :

1. The sponsor or, if so authorised by the trust deed, the trustee shall, appoint an asset management company, which has been approved by the Board under sub-regulation (2) of regulation 21.
2. The appointment of an asset management company can be terminated by majority of the trustees or by seventy five per cent of the unit-holders of the scheme.
3. Any change in the appointment of the asset management company shall be subject to prior approval of the Board and the unit holders.

Asset Management Company - Eligibility Criteria for Appointment

The eligibility criteria for appointment of Asset Management Company is prescribed in Regulation 21.

1. For grant of approval of the asset management company the applicant has to fulfil the following: -

    a. in case the asset management company is an existing asset management company it has a sound track record, general reputation and fairness in transactions;

    Explanation: For the purpose of this clause sound track record shall mean the net worth and the profitability of the asset management company.

b. the asset management company is a fit and proper person.

c. the directors of the asset management company are persons having adequate professional experience in finance and financial services related field and not found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws

d. the key personal of the asset management company have not been found guilty of moral turpitude or convicted of economic offence or violation of securities laws or worked for any asset management company or mutual fund or any intermediary during the period when its registration has been suspended or cancelled at any time by the Board;

e. the board of directors of such asset management company has at least fifty percent directors, who are not associate of, or associated in any manner with, the sponsor or any of its subsidiaries or the trustees;

f. the Chairman of the asset management company is not a trustee of any mutual fund;

g. the asset management company has a net worth of not less than rupees ten crores:

Provided that an asset management company already granted approval under the provisions of Securities and Exchange Board of India (Mutual Funds) Regulations, 1993 shall within a period of twelve months from the date of notification of these regulations increase its net worth to rupees ten crores.

Provided that the period specified in the first proviso may be extended in appropriate cases by the Board upto three years for reasons to be recorded in writing.

Provided further that no new schemes shall be allowed to be launched or managed by such asset management company till the net worth has been raised to Rupees ten crores.

Explanation: For the purposes of this clause, "net worth" means the aggregate of the paid up capital and free reserves of the asset management company after deducting therefrom miscellaneous expenditure to the extent not written off or adjusted or deferred revenue expenditure, intangible assets and accumulated losses.

2. The Board may, after considering an application with reference to the matters specified in sub-regulation (1), grant approval to the asset management company.

Regulation: 22 -Terms and Conditions to be Complied with

The approval granted under sub-regulation (2) of regulation 21 shall be subject to the following conditions, namely :-

a. any director of the asset management company shall not hold the office of the director in another asset management company unless such person is an independent director referred to in clause (d) of sub-regulation (1) of regulation 21 and approval of the board of asset management company of which such person is a director, has been obtained;

b. the asset management company shall forthwith inform the Board of any material change in the information or particulars previously furnished, which have a bearing on the approval granted by it;

c. no appointment of a director of an asset management company shall be made without prior approval of the trustees;

d. the asset management company undertakes to comply with these regulations;

e. no change in the controlling interest of the asset management company shall be made unless, -

   i. prior approval of the trustees and the Board is obtained;

   ii. a written communication about the proposed change is sent to each unit holder and an advertisement is given in one English daily newspaper having nationwide circulation and in a newspaper

published in the language of the region where the Head Office of the mutual fund is situated; and

iii. the unit holders are given an option to exit on the prevailing Net Asset Value without any exit load

Provided that in case of an open ended scheme, the consent of the unit holders shall not be necessary if ;

i. the change in control takes place after one year from the date of allotment of units

ii. the unit holders are informed about the proposed change in the controlling interest of asset management company by sending individual communication and an advertisement is given in one English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is situated.

iii. the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load."

f. The asset management company shall furnish such information and documents to the trustees as and when required by the trustees.

Regulation 23 - Procedure where Approval is not Granted

Where an application made under regulation 19 for grant of approval does not satisfy the eligibility criteria laid down in regulation 21, the Board may reject the application.

Regulation 24 - Restrictions on Business Activities of the Asset Management Company

The restrictions on business activities of the Asset Management Company are detailed below :

The asset management company shall

1. not act as a trustee of any mutual fund;

2. not undertake any other business activities except activities in the nature of portfolio management services management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis if any of such activities are not in conflict with the activities of the mutual fund;

   (a) Provided that the asset management company may itself or through its subsidiaries undertake such activities if it satisfies the Board that the key personnel of the asset management company, the systems, back office, bank and securities accounts are segregated activity wise and there exist systems to prohibit access to inside information of various activities.

   (b) Provided further that asset management company shall meet capital adequacy requirements, if any, separately for each such activity and obtain separate approval, if necessary under the relevant regulations.

3. the asset management company shall not invest in any of its schemes unless full disclosure of its intention to invest has been made in the offer documents in case of schemes launched after the notification of these regulations. Provided that an asset management company shall not be entitled to charge any fees on its investment in that scheme.

Regulation 25 - Asset Management Company and its Obligations

1. The asset management company shall take all reasonable steps and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of these regulations and the trust deed.

2. The asset management company shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business.

3. The asset management company shall be responsible for the acts of commissions or omissions by its employees or the persons whose services have been procured by the asset management company.

4. The asset management company shall submit to the trustees quarterly reports of each year on its activities and the compliance with these regulations.

5. The trustees at the request of the asset management company may terminate the assignment of the asset management company at any time:

   Provided that such termination shall become effective only after the trustees have accepted the termination of assignment and communicated their decision in writing to the asset management company.

6. Notwithstanding anything contained in any contract or agreement or termination, the asset management company or its directors or other officers shall not be absolved of liability to the mutual fund for their acts of commission or omissions, while holding such position or office.

7 .a. An asset management company shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5% or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes.

   Provided that for the purpose of this sub-regulation, aggregate purchase and sale of securities shall exclude sale and distribution of units issued by the mutual fund.

   Provided further that the aforesaid limit of 5% shall apply for a block of any three months.

   b. An asset management company shall not purchase or sell securities through any broker other than a broker referred to in clause (a) of sub-regulation (7) which is average of 5% or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes, unless the asset management company has recorded in writing the justification for exceeding the limit of 5% and reports of all such investments are sent to the trustees on a quarterly basis.

   Provided that the aforesaid limit shall apply for a block of three months.

8. An asset management company shall not utilise the services of the sponsor or any of its associates, employees or their relatives, for the purpose of any securities transaction and distribution and sale of securities:

Provided that an asset management company may utilise such services if disclosure to that effect is made to the unit holders and the brokerage or commission paid is also disclosed in the half yearly annual accounts of the mutual fund.

Provided further that the mutual funds shall disclose at the time of declaring half-yearly and yearly results;

i. any underwriting obligations undertaken by the schemes of the mutual funds with respect to issue of securities associate companies,

ii. devolvement, if any,

iii. subscription by the schemes in the issues lead managed by associate companies

iv. subscription to any issue of equity or debt on private placement basis where the sponsor or its associate companies have acted as arranger or manager.

9. The asset management company shall file with the trustees the details of transactions in securities by the key personnel of the asset management company in their own name or on behalf of the asset management company and shall also report to the Board, as and when required by the Board.

10. In case the asset management company enters into any securities transactions with any of its associates a report to that effect shall be sent to the trustees at its next meeting.

11. In case any company has invested more than 5 per cent of the net asset value of a scheme, the investment made by that scheme or by any other scheme of the same mutual fund in that company or its subsidiaries shall be brought to the notice of the trustees by the asset management company

and be disclosed in the half yearly and annual accounts of the respective schemes with justification for such investment provided the latter investment has been made within one year of the date of the former investment calculated on either side.

12. The-asset management company shall file with the trustees and the Board

   a. detailed bio-data of all its directors along with their interest in other companies within fifteen days of their appointment; and

   b. any change in the interests of directors every six months.

   c. a quarterly report to the trustees giving details and adequate justification about the purchase and sale of the securities of the group companies of the sponsor or the asset management company as the case may be, by the mutual fund during the said quarter.

13. Each director of the Asset Management Company shall file the details of his transactions of dealing in securities with the trustees on a quarterly basis in accordance with the guidelines issued by the Board.

14. The asset management company shall not appoint any person as key personnel who has been found guilty of any economic offence or involved in violation of securities laws.

15. The asset management company shall appoint registrars and share transfer agents who are registered with the Board.

   Provided if the work relating to the transfer of units is processed in-house, the charges at competitive market rates may be debited to the scheme and for rates higher than the competitive market rates, prior approval of the trustees shall be obtained and reasons for charging higher rates shall be disclosed in the annual accounts

16. The asset management company shall abide by the code of conduct as specified in the Fifth Schedule.

Regulation 26 , 27 - Appointment of and Agreement with Custodian

The appointment of Custodian is briefed in Regulation 26 as follows:

1. The mutual fund shall appoint a custodian to carry out the custodial services for the schemes of the fund and sent intimation of the same to the Board within fifteen days of the appointment of the custodian.

2. No custodian in which the sponsor or its associates hold 50% or more of the voting rights of the share capital of the custodian or where 50% or more of the directors of the custodian represent the interest of the sponsor or its associates shall act as custodian for a mutual fund constituted by the same sponsor or any of its associate or subsidiary company.

   The agreement to be entered with Custodian is briefed in Regulation 27

The mutual fund shall enter into a custodian agreement with the custodian, which shall contain the clauses that are necessary for the efficient and orderly conduct of the affairs of the custodian.

Provided that the agreement, the service contract, terms and appointment of the custodian shall be entered into with the prior approval of the trustees.

Regulation 28 - Procedure for launching of schemes

1. No scheme shall be launched by the asset management company unless such scheme is approved by the trustees and a copy of the offer document has been filed with the Board.

2. Every mutual fund shall along with the offer document of each scheme pay filing fees as specified in the Second Schedule.

Regulation 29 - Disclosures in the Offer Document

1. The offer document shall contain disclosures which are adequate in order to enable the investors to make informed investment decision including the disclosure on maximum investments proposed to be made by the scheme in the listed securities of the group companies of the sponsor.

2. The Board may in the interest of investors require the asset management company to carry out such modifications in the offer document as it deems fit.

3. In case no modifications are suggested by the Board in the offer document within 21 working days from the date of filing, the asset management company may issue the offer document.

4. No one shall issue any form of application for units of a mutual fund unless the form is accompanied by the memorandum containing such information as may be specified by the Board.

Regulation 29A - Nomination

1. The asset management company shall provide an option to the unit holder to nominate, in the manner specified in Fourth Schedule, a person in whom the units held by him shall vest in the event of his death.

2. Where the units are held by more than one person jointly, the joint unit holders may together nominate a person in whom all the rights in the units shall vest in the event of death of all the joint unit holders.

Regulation 30 – Code of Conduct for Advertisements

1. Advertisements in respect of every scheme shall be in conformity with the Advertisement Code as specified in the Sixth Schedule and shall be submitted to the Board within 7 days from the date of issue.

2. The advertisement for each scheme shall disclose investment objective for each scheme.

With an objective to improve the standard of disclosures in advertisements, effective implementation of regulatory intent and to remove difficulties in the application of Regulations, the following guidelines are being issued after consultation with AMFI, in accordance with Regulation 77 of the SEBI (Mutual Funds) Regulations, 1996.

1. Advertisements through Hoardings / Posters

It is essential for the investors to read the offer documents and risk factors before investing in mutual funds schemes to take well informed investment decisions. Considering that the investors get very little time to read the advertisements through hoardings / posters, etc. while passing by, it is clarified

that such advertisements may carry only the following statement apart from copy of advertisement: "Mutual Fund investments are subject to market risks, read the offer document carefully before investing".

The above statement shall be displayed in black letters of at least 8 inches height or covering 10% of the display area, on white background. The compliance officers shall ensure that the statement appearing in such advertisements are in legible font.

2. Advertisements through Audio-Visual Media

Likewise, in advertisements through audio-visual media like television, a statement "Mutual Fund investments are subject to market risks, read the offer document carefully before investing" shall be displayed on the screen for at least 2 seconds, in a clearly legible font-size covering at least 80% of the total screen space and accompanied by a voice-over reiteration. The remaining 20% space can be used for the name of the mutual fund or logo or name of scheme, etc.

Advertisements through audio media like radio, cassettes, CDs etc. shall also read the above statement in a way that is easilv understandable to the listeners.

3. Promotional Activities, Sales Literature

Section II of aforesaid SEBI Guidelines issued on June 5, 2000 prescribes standards for various forms of communications by the mutual funds. It is clarified that the same standards shall be followed in case of activities organized to promote mutual funds/schemes/asset management companies

The above guidelines are also applicable for sales literature. With a view to broaden the definition of sales literature as specified in the Guidelines, it is clarified that it shall also include fund fact sheets, research reports, newsletters, performance reports or summaries, telemarketing scripts, seminar texts, press releases and reprints or excerpts of any other advertisements or published article, etc.

4. Performance Advertisements

i) **Disclosure of Benchmarks in Advertisements:** The earlier guidelines (Section III, Clause 3.7) prescribe the type of benchmark indices that can be used in performance advertisements of mutual funds schemes.

Subsequently, the disclosure of benchmarks in the offer documents and comparison of returns with benchmarks while publishing half-yearly results were made mandatory. Henceforth, all performance advertisements disclosing return statistics shall also mention the returns on the benchmark indices, during the same time periods.

ii) **Performance of Money Market Schemes:** Referring to Clause 3.4 (Section III) of the guidelines, considering that the investors in cash/liquid/money market schemes have very short investment horizon, the mutual funds while advertising simple annualized returns of such schemes based on a period of 30 days can also advertise simple annualized returns based on 15 day period.

iii) **Impact of Distribution Taxes:** While advertising returns by assuming reinvestment of dividends, if distribution taxes are excluded while calculating the returns, this fact may also be disclosed.

iv) **Pay-out of Dividend:** While advertising pay-out of dividends, it shall be disclosed that after the payment of the dividend, the NAV will fall to the extent of the pay out and distribution taxes (if applicable), in the main body of advertisement.

5. Ranking advertisements

Clause 3.7 d (1) of the aforesaid Guidelines, shall be substituted as follows:

Any ranking set forth in an advertisement or sales literature must be current to the most recent quarter ended or such periodicity / frequency of ranking as may be applicable, in the case of advertising prior to the submission for publication or in the case of sales literature prior to use".

The requirements pertaining to advertisements should be complied by mutual funds in letter and spirit.

As per regulation 31 the offer document and advertisement materials shall not be misleading or contain any statement or opinion which are incorrect or false.

Regulations 32-37 - Regulations for Closed Ended Schemes

The regulations for the various aspects of closed ended schemes are discussed hereunder :

The regulations cover the listing, repurchase, offer period, allotment of units and return of moneys, unit certificate, statement of account, transfer of units, etc .

a. Regulation 32 - Listing of Close Ended Schemes

Every close-ended scheme shall be listed in a recognised stock exchange within six months from the closure of the subscription.

Provided that listing of close-ended scheme shall not be mandatory -

a. if the said scheme provides for periodic repurchase facility to all the unit holders with restriction, if any, on the extent of such repurchase; or
b. if the said scheme provides for monthly income or caters to special classes of persons like senior citizens, women, children, widows or physically handicapped or any special class of persons providing for repurchase of units at regular intervals; or
c. if the details of such repurchase facility are clearly disclosed in the offer document; or
d. if the said scheme opens for repurchase within a period of six months from the closure of subscription.

b. Regulation 33 - Repurchase of Close Ended Schemes

1. The asset management company may at its option repurchase or reissue the repurchased units of a close ended scheme.
2. The units of close ended schemes referred to in the proviso to regulation 32 may be open for sale or redemption at fixed pre-determined intervals if the maximum and minimum amount of sale or redemption of the units and the periodicity of such sale or redemption have been disclosed in the offer document.
3. The units of close ended scheme may be converted into open ended scheme,-
    a. if the offer document of such scheme discloses the option and the period of such conversion; or

b. the unit holders are provided with an option to redeem their units in full.

4. A close-ended scheme shall be fully redeemed at the end of the maturity period.

Provided that a close ended scheme may be allowed to be rolled over if the purpose, period and other terms of the roll over and all other material details of the scheme including the likely composition of assets immediately before the roll over, the net assets and net asset value of the scheme, are disclosed to the unit holders and a copy of the same has been filed with the Board.

c. Regulation 34 - Offering Period

No scheme of a mutual fund other than the initial offering period of any equity linked savings schemes shall be open for subscription for more than 45 days.

d. Regulation 35 - Allotment of Units and Refunds of Moneys

1. The asset management company shall specify in the offer document, -
   a. the minimum subscription amount it seeks to raise under the scheme; and
   b. in case of over subscription the extent of subscription it may retain.

   Provided that where the asset management company retains the over subscription referred to in clause (b), all the applicants applying upto five thousand units shall be given full allotment subject to the over-subscription mentioned in clause (b).

2. The mutual fund and asset management company shall be liable to refund the application money to the applicants,-
   i. if the mutual fund fails to receive the minimum subscription amount referred to in clause (a) of sub-regulation (1);
   ii. if the moneys received from the applicants for units are in excess of subscription as referred to in clause (b) of sub-regulation (1).

3. Any amount refundable under sub-regulation (2) shall be refunded within a period of six weeks from the date of closure of subscription list, by Registered A.D and by cheque or demand draft marked "A/C Payee" to the applicants.

4. In the event of failure to refund the amounts within the period specified in sub-regulation (3), the asset management company shall be liable to pay interest to the applicants at a rate of fifteen percent per annum on the expiry of six weeks from the date of closure of the subscription list.

e. Regulation 36 - Unit Certificates or Statement of Accounts

The asset management company shall issue to the applicant whose application has been accepted, unit certificates or a statement of accounts specifying the number of units allotted to the applicant as soon as possible but not later than six weeks from the date of closure of the initial subscription list and or from the date of receipt of the request from the unit holders in any open ended scheme.

Provided that if an applicant so desires, the asset management company shall issue the unit certificates to the applicant within six weeks of the receipt of request for the certificate.

f. Regulation 37 - Transfer of units

1. An unit certificate unless otherwise restricted or prohibited under the scheme, shall be freely transferable by act of parties or by operation of law.

2. The asset management company shall, on production of instrument of transfer together with relevant unit certificates, register the transfer and return the unit certificate to the transferee within thirty days from the date of such production.

3. Provided that if the units are with the depository such units will be transferable in accordance with the provisions of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996.

Regulation 38 - Guaranteed returns

The restrictions for guaranteeing returns are prescribed in Regulation 38.

No guaranteed return shall be provided in a scheme, -

a. unless such returns are fully guaranteed by the sponsor or the asset management company;

b. unless a statement indicating the name of the person who will guarantee the return, is made in the offer document;

c. the manner in which the guarantee to be met has been stated in the offer document.

Regulation 39 to 42 - Winding Up

The steps for winding up, effect of winding up, procedure and manner of winding up and ceasing of a mutual fund scheme are dealt in Regulation 39 to 42.

a. Regulation 39 - Winding up

1. A close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled-over for a further period under sub-regulation (4) of regulation 33.

2. A scheme of a mutual fund may be wound up, after repaying the amount due to the unit holders,-

    a. on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or

    b. if seventy five per cent of the unit holders of a scheme pass a resolution that the scheme be wound up; or

    c. if the Board so directs in the interest of the unit-holders.

3. Where a scheme is to be wound up under sub-regulation (2), the trustees shall give notice disclosing the circumstances leading to the winding up of the scheme:-

    a. to the Board; and

    b. in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed.

b. Regulation 40 - Effect of Winding Up

On and from the date of the publication of notice under clause (b) of sub-regulation (3) of regulation 39, the trustee or the asset management company as the case may be, shall-

a. cease to carry on any business activities in respect of the scheme so wound up
b. cease to create or cancel units in the scheme;
c. cease to issue or redeem units in the scheme.

c. Regulation 41 - Procedure and Manner of winding up

1. The trustee shall call a meeting of the unit holders to approve by simple majority of the unit holders present and voting at the meeting resolution for authorising the trustees or any other person to take steps for winding up of the scheme.

   Provided that a meeting of the unit holders shall not be necessary if the scheme is wound up at the end of maturity period of the scheme.

2.
   a. The trustee or the person authorised under sub-regulation (1) shall dispose of the assets of the scheme concerned in the best interest of the unit holders of that scheme.
   b. The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unit holders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken.

3. On the completion of the winding up, the trustee shall forward to the Board and the unit holders a report on the winding up containing particulars such as circumstances leading to the winding up, the steps taken for disposal of assets of the fund before winding up, expenses of the fund for winding up, net assets available for distribution to the unit holders and a certificate from the auditors of the fund.

4. Notwithstanding anything contained in this regulation, the provisions of these regulations in respect of disclosures of half yearly reports and annual reports shall continue to be applicable 43*[until winding up is completed or the scheme ceases to exist.

d. Regulation 42 - Winding up of the scheme

After the receipt of the report under sub-regulation (3) of Regulation 41, if the Board is satisfied that all measures for winding up of the scheme have been complied with, the scheme shall cease to exist.

Regulation 43 to 47 - Investment Objectives and Valuation Policies

The investment objectives and valuation policies of mutual funds are dealt in Regulation 43 to 47.

a. Regulation 43 - Investment Objective

The moneys collected under any scheme of a mutual fund shall be invested only in transferable securities in the money market or in the capital market or in privately placed debentures or securitised debts.

Provided that moneys collected under any money market scheme of a mutual fund shall be invested only in money market instruments in accordance with directions issued by the Reserve Bank of India;

Provided further that in case of securitised debts such fund may invest in asset backed securities and mortgaged backed securities.

b. Regulation 44 - Investment, & Borrowing, Restriction

1. Any investments to be made under regulation 43 shall be invested subject to the investment restriction specified in the Seventh Schedule.

1. A) The mutual fund having an aggregate of securities which are worth Rs.10 crores or more, as on the latest balance sheet date, shall subject to such instructions as may be issued from time to time by the Board settle their transactions entered on or after January 15, 1998 only through dematerialised securities.

2. The mutual fund shall not borrow except to meet temporary liquidity needs of the mutual funds for the purpose of repurchase redemption of units or payment of interest or dividend to the unit holders.

   Provided that the mutual fund shall not borrow more than 20% of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months.

3. The mutual fund shall not advance any loans for any purpose.

4. The mutual fund may lend securities in accordance with the Stock Lending Scheme of the Board.

c. Regulation 45 – Option Trading

The funds of a scheme shall not in any manner be used in option trading or in short selling or carry forward transactions.

Provided that mutual funds shall enter into derivative transactions in a recognised stock exchange for the purpose of hedging and portfolio balancing, in accordance with the guidelines issued by the Board.

d. Regulation 46 – Underwriting of Securities

Mutual funds may enter into underwriting agreement after obtaining a certificate of registration in terms of the Securities and Exchange Board of India (Underwriters) Rules and Securities and Exchange Board of India (Underwriters) Regulations, 1993 authorising it to carry on activities as underwriters.

1. *Explanation:* For the purpose of these regulations, the underwriting obligation will be deemed as if investments are made in such securities.

2. The capital adequacy norms for the purpose of underwriting shall be the net asset of the scheme.

   Provided that the underwriting obligation of a mutual fund shall not at any time exceed the total net asset value of the scheme.

2. Regulation 48 - Net Asset Value

The computation of Net Asset Value is discussed in Regulation 48

The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV).

Mutual funds invest the money collected from the investors in securities markets. In simple words, Net Asset Value is the market value of the securities held by the scheme. Since market value of securities changes every day, NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is Rs 200 lakhs and the mutual fund has issued 10 lakhs units of Rs. 10 each to the investors, then the NAV per unit of the fund is Rs.20. NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

1. Every mutual fund shall compute the Net Asset Value of each scheme by dividing the net assets of the scheme by the number of units outstanding on the valuation date.

2. The Net Asset Value of the scheme shall be calculated and published at least in two daily newspapers at intervals of not exceeding one week

   Provided that the Net Asset Value of any scheme for special target segment or any monthly income scheme which are not mandatorily required to be listed in any stock exchange under Regulation 32, may publish the Net Asset Value at monthly or quarterly intervals as may be permitted by the Board.

   The Net Asset Value of the Mutual fund scheme is basically the per unit Market value of all the assets of the scheme.

$$\text{NAV} = \frac{\text{Market Value of the Assets in the Scheme + Receivables + Accrued Income - Liabilities - Accrued Expenses}}{\text{No. of units outstanding}}$$

Receivables	Whatever the Profit is earned out of sold stocks by the Mutual fund is called Receivables.
Accrued Income	Income received from the investment made by the Mutual Fund.
Liabilities	Whatever they have to pay to other companies are called liabilities.
Accrued Expenses	Day to day expenses such as postal expenses, Printing, Advertisement Expenses etc.,

CALCULATION OF NAV

SCHEME	ABN
SCHEME SIZE	Rs. 5,00,00,000 (FIVE CRORES)
FACE VALUE OF UNITS	Rs.10/-

$$\frac{\text{Scheme Size}}{\text{Face value of units}} = \frac{5,00,00,000}{10} = 50,00,000$$

The fund will offer 50,00,000 units to Public.

Investments : Equity shares of Various Companies. Market Value of Shares is Rs.10,00,00,000 (Ten Crores)

$$\text{NAV} = \frac{\text{Rs.}10,00,00,000}{50,00,000 \text{ units}} = \text{Rs.}20/-$$

Thus each unit of Rs. 10/- is Worth Rs.20/-. It states that the value of the money has appreciated since it is more than the face value.

Provided that the Net Asset Value of any scheme for special target segment or any monthly income scheme which are not mandatorily required to be listed in any stock exchange under Regulation 32, may publish the Net Asset Value at monthly or quarterly intervals as may be permitted by the Board.

3. VALUATION SYSTEM FOR NAV

3.1 Regulation 47 - Method of valuation of investments

Every mutual fund shall compute and carry out valuation of its investments in its portfolio and publish the same in accordance with the valuation norms specified in Eighth Schedule.

As explained previously, mutual funds invest the funds collected under the various schemes from the investors, in different types of securities like equities, debt instruments and other money market instruments.

The investments are made to maximise the NAV as a value enhancer for the investors.

The valuation of NAV is based on the valuation of the different invested securities. We will discuss below the valuation methodology to be adopted for valuation of securities invested by the mutual funds.

3.2 VALUATION OF EQUITY SECURITIES

The methodology for valuation of equity securities is as follows:

First, the mutual fund determines the stock exchange that would be the principal stock exchange for valuation of each security.

The principal stock exchange can be determined as a policy such as "exchange where the trading volume is maximum on that day" or "NSE preferred or BSE. But once the stock exchange is selected for a security, it can be changed only with a valid justification and with the approval of the trustees.

The closing price of the equity in that exchange on that date will be used for valuation, so long as the security is traded in the principal stock exchange on the valuation date.

If the stock is not traded on the principal exchange on that date, the closing price on any other stock exchange where it is traded on that date will be used for valuation.

If the stock is not traded on any exchange on that date, then the last traded price on any exchange will be used for valuation, so long as the trade is on a date not more than thirty days prior to the valuation date.

If there is no trade on any exchange during the thirty days period prior to the date of valuation, it will be valued as a non traded security.

For thinly traded securities (trades less than Rs.500000 in value or 50000 shares in volume during the preceding calendar), a separate valuation policy is adopted base don the net worth of the latest audited balance sheet. If the audited balance sheet is not available within nine months from the close of the year, the shares will be valued at zero. If an individual security accounts for more than five percent of the total assets of the scheme. an independent valuer has to be appointed for valuing the security.

3.3 VALUATION OF DEBT SECURITIES

The valuation method followed for different debt securities is described below:

3.3.1 Government Securities:

Any Government security is to be valued at the prevailing market price.

Securities that are not traded on the valuation date need to be valued based on yield to maturity implicit in the prevailing market prices of similar securities, unless it is a money market security.

Mutual funds have been advised to use the prices for Government securities released by an agency suggested by AMFI, for the sake of uniformity in NAV.

3.3.2 Money Market Securities:

Money market securities (securities of less than six months balance tenor) are valued on the basis of amortisation i.e., cost plus accrued interest till the beginning of the valuation day plus the difference between the redemption value and the cost, spread uniformly over the remaining maturity period.

3.3.3 Non Traded/Thinly Traded Debt Securities (other than Government Securities):

A debt security as above is considered as non-traded if it is not traded during a period of fifteen days prior to the valuation date in any stock exchange in the country.

A debt security is considered as thinly traded if on the valuation date there are no individual trades in that security in marketable lots (Rs 5 Crores) on the principal stock exchange of any other stock exchange.

The above securities will be valued as money market securities if the tenor is less than 182 days. If the tenor is more than 182 days, different valuation method will be adopted base on whether the security is investment grade or non investment grade. If the securities are investment grade, valuation will be done on yield to maturity basis. If non investment grade and non performing, the valuation is done based on provisioning norms.

4. REGULATION 49 - PRICING OF UNITS

1. The price at which the units may be subscribed or sold and the price at which such units may at any time be repurchased by the mutual fund shall be made available to the investors.

2. The mutual fund, in case of open-ended scheme, shall at least once a week publish in a daily newspaper of all India circulation, the sale and repurchase price of units.

3. While determining the prices of the units, the mutual fund shall ensure that the repurchase price is not lower than 93% of the Net Asset Value and the sale price is not higher than 107% of the Net Asset Value.

   Provided that the repurchase price of the units of a close ended scheme shall not be lower than 95% of the Net Asset Value:

   Provided further that the difference between the repurchase price and the sale price of the unit shall not exceed 7% calculated on the sale price.

4. The price of units shall be determined with reference to the last determined Net Asset Value as mentioned in sub-regulation (3) unless,

   a. the scheme announces the Net Asset Value on a daily basis; and

   b. the sale price is determined with or without a fixed premium added to the future net asset value which is declared in advance.

To avoid any fraudulent encashment of any cheque/draft issued by the mutual fund at a later date for the purpose of dividend or repurchase. Any changes in the address, bank account number, etc at a later date should be informed to the mutual fund immediately.

5. ACCOUNTING NORMS

5.1 REVENUE ACCOUNT AND BALANCE SHEET :

In all mutual funds, the Asset Management Company will have a Balance Sheet and Profit and Loss Account.

It is mandatory for the AMCs to make their financial statements available in the website.

The prescribed minimum share capital should be Rs.10 crores.

Income for the AMC comes from the management fees and the expenses are for infrastructure, systems development, advertisement, staff cost etc. If the expenses are more than the income, then the capital is eroded. The Rs.10 crores capital is to be maintained at all times as prescribed by SEBI. The review is to be done once in a quarter and the shortfall to be made good by the trustees.

The revenue account and the balance sheet of the schemes are independent of the profit and loss account and the balance sheet of the AMC. Each scheme will have its own revenue account.

The money invested by the investors in various schemes would go into the balance sheet of the scheme, split into unit capital, unit premium reserve, and equalisation reserve.

The difference between the NAV and the sale or repurchase price on account of the entry load or the exit load goes into a separate account from

which the AMC would meet part of its selling and distribution expenses. The load collected from the investors can go the books of the schemes or the books of the investor. If the same is transferred to the books of the AMC, it would be treated as other income and be liable to tax.

Income for the scheme would be in the form of interest, dividend and any capital gains realised.

Expenses for the schemes would be in the nature of agent's commission, trusteeship fees, audit fees, registrar and transfer agent fees, management fees etc.

The difference between the income net expenses would be the profit or loss for the period. The balance would be carried over to the balance sheet as reserves, subject to any dividend payout and tax and after netting the appreciation/ depreciation in investments.

For multiple options under a scheme , income and expenses may be maintained for the entire scheme and the profits and losses are apportioned between the options to determine the NAV of each scheme.

6. DISCLOSURE NORMS

Disclosures about NAV and other disclosures are to be made daily, weekly, half yearly and annual.

6.1 DAILY DISCLOSURES :

Every day by 8.00 p.m , the NAVs of different schemes of mutual funds are to required to be updated on the AMFI website (www.amfiindia.com).

NAVs of open ended schemes are to be published daily in atleast two daily newspapers.

Sale and repurchase prices of units are to be published in a daily newspaper on a daily basis.

6.2 WEEKLY DISCLOSURES

NAVs of closed-ended schemes are to be published atleast in two daily newspapers at intervals not exceeding one week.

For uniformity and comparability ,all mutual fund closed ended schemes need to publish the NAVs on each Wednesday.

6.3 HALF YEARLY DISCLOSURES

First, within one month of the close of each half year, mutual funds are required to publish their unaudited financial results a per the prescribed format along with other mandated disclosures such as :

- Effect of changes in any accounting policies
- Investment made in associate companies, payments to associate companies' etc,
- Investments made in companies that have invested in more than 5% of the NAVs.
- Large holdings (over 25% of the corpus of the scheme),including information about the investors and total holdings by them in percentage terms. The same is to be disclosed also in allotment letters after initial public offer and in the annual results.
- Any bonus declared during the half year in respect of the scheme.
- Borrowings above 10 % of the NAV
- Exposure to derivatives above 10 % of the NAV
- Deferred revenue expenditure.

The above information has to be published in one national English daily newspaper and in a newspaper in the language of the region where the head office of the fund is situated.

Secondly, before the expiry of one month from the close of each half year, mutual funds are required to publish their scheme portfolio in the prescribed format in one National English daily newspaper and in a newspaper in the language of the region where the head office of the fund is situated alternatively they may send a copy to all the unit holders.

6.4 ANNUAL DISCLOSURES

Annually, abridged schemewise annual report has to be mailed to all the unit holders not later than six months from the date of closure of the relevant

accounting year. The full and unabridged annual report has also to be available for inspection at the head office of the fund and a copy made available to the unit holders on request on payment of nominal fees, if any.

SUGGESTED QUESTIONS

1. Discuss the features of regulations regarding the appointment and approval of trustees.
2. Explain elaborately the rights and obligations of the trustees of mutual funds.
3. What are the two methods of due diligence exercised by the trustees. Discuss.
4. Discuss the features of Code of Conduct governing Trustees and Asset Management Companies of mutual funds.
5. Discuss in detail the regulations for appointment and eligibility criteria for appointment of Asset Management Company.
6. Discuss briefly the restrictions on business activities of the Asset Management Company.
7. Elaborate the features of the regulation regarding obligations of Asset Management Company.
8. Discuss the regulation requirement regarding the Code of Conduct for Advertisements of mutual funds.
9. Explain the features of regulations regarding listing and repurchase of Close Ended Schemes.
10. Discuss in detail allotment, refund, despatch and transfer of units of mutual funds.
11. Write a note on the various steps in winding up of mutual funds.
12. What is Net Asset Value? Explain how to calculate Net Asset Value?
13. Discuss in detail the valuation system for Net Asset Value and the valuation methods to be followed for different types of securities.
14. Write a short note on Pricing on Units of mutual funds
15. Write a note on the disclosure norms to be followed by mutual funds.

UNIT 5

1. MUTUAL FUNDS IN INDIA

1.1 HISTORY

The history of Indian mutual fund industry can be distinctly divided into two phases

- the period before liberalisation when only public sector players existed with one dominant player Unit Trust of India and
- the post-liberalisation era where the industry was opened up to private players.

Unit Trust of India (UTI) was established in 1963 and launched its legendary first scheme 'US-64' in 1964. UTI witnessed a slow and steady growth over seventies and eighties and by end of 1988 it had an AUM of Rs. 67,000 million. From 1987, non-UTI, public sector mutual funds were allowed and a series of mutual fund companies were set up by public sector banks and financial institutions. At the end of 1993, the overall AUM (Assets Under Management) of mutual fund industry was Rs. 470,004 million.

The mutual fund industry was opened up for private participation 1993 and a new era was ushered in, paving the way for an unprecedented choice of products and services to Indian investors. Detailed guidelines were established and the mutual fund industry (except UTI) came under the regulation of Securities Exchange Board of India (SEBI).

Many reputed foreign mutual funds such as Templeton, Alliance, Prudential group etc. set up operations in India. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,218,050 million.

In February 2003, the Unit Trust of India Act 1963 was repealed and UTI was broken into two separate entities.

One is the Specified Undertaking of the Unit Trust of India, still under the control of Government of India with AUM of Rs. 298,350 million as at the end of January 2003.

The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations.

As at the end of October 31, 2003, there were totally 31 funds in India, with assets under management of about Rs. 1,267,260 million.

The asset size of Indian mutual funds have grown by about 20 per cent from Rs 47,000 crores in March 1993 to Rs 1,40,000 crores in December 2003 due to shift in investor preference for MFs and growing presence of private sector fund companies, according to CRISIL sectoral study.

The shift in preference towards MFs has been facilitated by fiscal incentives, increasing returns from debt mutual fund investments due to the decline in interest rates and the growing number of choices available to investors.

Excluding Unit Trust of India (UTI), however, the growth has been a staggering eight-fold in just under five years, from Rs 15,200 crore as at March 1999 to Rs 1,20,300 crores at December 2003.

The gradual change in the investors' risk profile and the Association of Mutual Funds of India's (AMFI) efforts for an appropriate regulatory environment have also contributed to growth of MF industry.

There is a huge latent growth potential as industry size is only four per cent of the country's gross domestic product (GDP), very low compared to developed markets like United States where the assets under the management were more than 60 per cent of the GDP, or developing countries like Brazil, where the AUM is over 20 per cent of the GDP, it added.

The prominent factors, which drive the MF industry, are tax and returns. Now, as the Government of India has made dividend tax-free, we are witnessing a good flow of money into MF. Tax rebates provide a level-playing field for MF vis-à-vis assured-return products of banks/government institutions. Specifically, the developments in macro economic regulations, equity & debt market and tax areas can alter the demand and relative competitive dynamics of the MF industry.

Mutual fund schemes undergo direct and indirect competition from other financial products. All the assured return schemes like FDs, Relief Bond and Post Office MIPs are direct competitors of MF products. Hence MFs must differentiate primarily through returns, liquidity, convenience and diversification.

Growth prospects are expected in Indian MF Industry. With the interest rate softening and most of the assured returns schemes lowering their interest rates, investors are ready to explore Mutual Funds as an avenue for investment. They have come to realise that risk and return go hand-in-hand. We anticipate that growth in the MF industry will occur as result of falling interest rates, performance of equity market and launch of more niche products. All investments in securities are subject to market risks and the NAV of the units issued under the different schemes may go up or down depending on the factors and forces affecting the capital markets. Performance of previous schemes/plans is not necessarily an indication of future results.

Mutual Funds Products are classified based on the underlying securities. Broadly there are two categories, namely Debt and Equity. These categories are further segmented into Equity Diversified, Sectoral Equity, Debt, Gilt, Liquid Fund, Index Fund, Exchange Traded Fund, MNC Fund and so on. Debt funds are also categorised into institutional and retail plans, based on the investment amount or into short-term and long-term plans based on the investment horizon. Derivative-based products, Fund of funds and Principal protection fund with the help of put option are perhaps products, which may be tested here in India. A put option, for the uninitiated, is a financial contract that acts as a hedge against declines in a stock's value. If the stock falls, the put options' value rises.

The three most popular categories of MF products are Income Funds with about 40 per cent market share, Liquid Fund with 35 per cent and Equity Diversified with 10 per cent. What we see is that a typical investor is ready to take an exposure of around 5-15 per cent of his portfolio to equity. Hence the basic psychology of the investor is the safety of his capital, followed by returns. Throughout India, income products are preferred

The fund industry has introduced the best of products and services, and delivered some superlative performances. But easy money from corporates and

an obsession with growing the corpus fast has skewed its priorities in favour of large investors.

Public Sector mutual funds have beaten private and foreign mutual funds (MFs) in asset moblisation. In July 2004, the MF industry managed to show a Rs1,902-crore growth in assets thanks to whopping inflows of Rs1,592 crores into SBI Mutual Fund and UTI Mutual Fund. The total assets under management (AUM) of the industry is now Rs1.577 lakh crores.(August 2004)

While assets of SBI MF have grown by Rs844 crores to Rs6,140 crores, UTI MF's AUM has increased by Rs748 crores. UTI MF, the largest fund house in the country, has total assets of Rs21,638 crores as on July 31,2004. This also includes the assets worth over Rs2,000 crores that came into the fund through the acquisition of IL&FS Mutual Fund.

Through trial and error, SEBI has steadily improved its regulation of the mutual fund industry. Corporate governance is better than before, but the last mile has still to be negotiated before investor confidence can be taken for granted.

The mutual fund business has not seen any major upheaval of the kind where investors have actually ended up losing money. The only case which came close to this is that of the Unit Trust of India (UTI), but the fact is that the government stepped in to prevent investors from losing too much.

A majority of private sector mutual funds have managed to outperform their benchmarks, drawing little ire from investors. Some of them do, in fact, charge fairly high fees, but good market performance has made the case for lower fees not as compelling as in America.

Even in the case of late trading – which has been more or less the norm in an industry where big corporates and distributors negotiate terms with mutual funds on a regular basis – malpractices have not been as rampant as in America.

While the mutual fund industry, thanks to its relatively small size till recently, has a bias towards large corporate investors, governance standards overall have improved, aided undoubtedly by significant regulatory changes over the last few years.

1.2 MEASURES BY SEBI TO IMPROVE FUNCTIONING OF MUTUAL FUNDS

SEBI plugged the holes in the system by following a trial-and-error approach, and not necessarily proactively. The regulatory regime was tightened bit by bit, aided by SEBI's experiences and market forces. The pace of regulation has actually accelerated in the last few years. The important measures are discussed below:

(a) During 2002-03, the regulator put out detailed guidelines on corporate governance practices for asset management companies (AMCs). One of these was the introduction of compulsory benchmarking of a fund's performance against any chosen index.

(b) The trustees of funds were also entrusted with the responsibility of reviewing the performance of various schemes against the benchmark index.

(c) Everyone, including the trustees, have been brought under the insider trading regulations. Trustees have to hold meetings at least once in two months as against four times a year previously.

(d) SEBI has also made it mandatory for the board of trustees to have two-thirds of its strength as independent directors – that is, those who are not associates of the sponsors. Consultants have also been brought under this definition.

(e) At the operational level, AMCs have been asked to put in place risk management systems for fund management, operations, and so on – with detailed guidelines being issued.

(f) SEBI has issued clear-cut guidelines for valuing bond instruments – traditionally a grey area – non-performing assets, and illiquid and unlisted securities. The Association of Mutual Funds of India (AMFI) has also helped in making product comparisons easy for investors by mandating funds to follow uniform sector classifications, as established by AMFI. Disclosure standards have also been improved substantially.

(g) SEBI has prescribed a code of conduct for mutual fund distributors. All of them have to be registered with the Association of Mutual Funds of India. Distributors also have to mandatorily pass a certification exam before they are allowed to sell any mutual fund products. But then, the onus is on the fund management to ensure that their agents and distributors do indeed follow the practices laid down in the code of conduct.

(h) SEBI and AMFI have dealt with some amount of success in the practice of rebating commissions back to investors. To hardsell a fund scheme, distributors often share a part of their distribution commission with brokers and retail investors as an incentive.. This amounts to promoting/selling schemes for the wrong reasons and may end up misleading the investor. SEBI has put the onus on the fund houses to monitor their distributors and stop incentivising investors. Despite all the laws that are on paper, given the extended area of operations of distributors, SEBI's writ may not run beyond a point. The only way the issue can really be tackled is to give professional intermediaries larger space in investment decisions.

(i) SEBI introduced uniform cut-off timings for equity and debt funds to curb late trading. Under this practice, mutual funds oblige their big investors by allowing them to purchase units at the previous day's NAV, enabling them to take advantage of any appreciation in market prices since then. It asked AMCs to set up time-stamping machines that would keep track of the date and time when applications and cheques were received to curb late trading.

With barely two per cent of household savings going into mutual funds, the segment has a lot of catching up to do. With post-office administered schemes and bank deposits offering competition, more investors can be enticed to the mutual fund industry only if it is steadily seen as very investor-friendly.

SEBI's initiatives have set the industry in the right direction, but the final destination is still some distance away.

1.3 DRIVERS SHAPING THE FUTURE OF THE INDUSTRY

Some of the drivers that are shaping the industry, which are likely to have substantial influence on the marketing strategies of the future are as follows:

(a) The average projected life span of an Indian after retirement (that is, after 60) is expected to go up from 15 years to 20 years. And the number of the elderly (those over 60) is expected to increase significantly from 6.8 per cent of the population in 1991 to 8.9 per cent in 2016 and further to 13.3 per cent by 2026. One of the key recommendations of the expert committee of Project OASIS (Old Age Social and Income Security) constituted by the government on pension reforms in 1999 is the creation of a privately managed, individual choice based, voluntary Pension system. Pension reform is likely to be a big driver. The government is finalising guidelines for specialised pension funds to operate in India.

(b) Advisory services are becoming more critical to investors and independent financial advisors and planners are gaining ground. The US accreditation body for Financial Planners was set up in Delhi in the name of Association of Financial Planners (AFP) and soon professional Certified Financial Planners (CFPs) will be available to investors to assist them in their financial planning needs. Banks are planning to enter into advisory services in a big way. An entirely new distribution channel will be created consisting professional advisors who will exert substantial influence on what products customers will buy.

(c) As investors turn more aware, either by themselves or with the help of financial planners, there will be demand for more specialised products; for example, based on different styles of fund management on the Value-Growth spectrum as well as on the Focussed-Diversified Investing spectrum. In other words, two equity schemes will be distinguished based on the fund management style - either the value investing style or growth investing style.

(d) Digital marketing: E-commerce is gradually showing signs of gaining acceptance and electronic sale of financial products is especially gaining volumes. There is a likelihood of the volumes reaching a significant size, thereby spawning a new distribution paradigm.

(e) As Indian markets mature, regulatory restrictions are easing, paving the way for introduction of innumerable specialised products hitherto not introduced in India such as hedge funds and derivative-based products.

2. PUBLIC AND PRIVATE SECTOR MUTUAL FUNDS

The charts I and II give the details of mutual funds operating in India and the important schemes floated by them. The chart II gives also the best top 5 funds under the important schemes (Source: Outlook Money)

Chart I gives the details on mutual funds in the private sector and the public sector. There are nine players in the public sector floated by banks and financial institutions and 21 players in the private sector floated by private banks, financial institutions and foreign players. Fidelity Mutual Fund from U.S.A is the latest player in the mutual fund industry.

Chart II gives the important schemes coming under the broad classification. Other focussed schemes will come under any of these broad categories. The top five performing schemes are also listed in the chart. However the ranking is purely for the time period given in the chart. The performance of mutual funds over a time period depends on so many factors which were discussed in detail in other chapters. The past performance need not be an indicator to future performance.

CHART- I

MUTUAL FUNDS IN INDIA

PUBLIC SECTOR

(BY BANKS &FIs)

1.UTI MUTUAL FUND

2.BOB MUTUAL FUND

3.CANBANK MUTUAL FUND

4.GIC MUTUAL FUND

5.HDFC MUTUAL FUND

6 LIC MUTUAL FUND

7. PNB MUTUAL FUND

8. PRUDENTIAL ICICI MUTUAL FUND

9. SBI MUTUAL FUND

PRIVATE SECTOR

1. ABN AMRO MUTUAL FUND

2. ALLIANCE CAPITAL MUTUAL FUND

3. BENCHMARK MUTUAL FUND

4. BIRLA SUNLIFE MUTUAL FUND

5.CHOLA MUTUAL FUND

6.DEUTSCHE MUTUAL FUND

7.DSP MERYLL LYNCH MUTUAL FUND

8.ESCORTS MUTUAL FUND

9.FIRST INDIA MUTUAL FUND

10.HSBC MUTUAL FUND

11.ING VYSYA MUTUAL FUND

12. JM MUTUAL FUND

13. KOTAK MAHINDRA MUTUAL FUND

14. MORGAN STANLEY MUTUAL FUND

15. PRINCIPAL MUTUAL FUND

16. RELIANCE CAPITAL MUTUAL FUND

17. STANDARD CHARTERED MUTUAL FUND

18. SUN F&C MUTUAL FUND

19. SUNDARAM MUTUAL FUND

20. TATA MUTUAL FUN

21. TAURUS MUTUAL FUND

22. TEMPLETON MUTUAL FUND

CHART II - IMPORTANT MUTUAL FUND SCHEMES AND BEST FUNDS 2005

1.EQUITY DIVERSIFIED

(1)RELIANCE VISION FUND(2) TEMPLETON INDIA GROWTH

(3)SBI MAGNUM CONTRA(4) FRANKLIN PRIMA FUND

(5)HDFC CAP BUILDER(D)

2. EQUITY –ELSS

(1)HDFC TAX SAVER(D) (2)FRANKLIN TAX SHIED

(3)SUNDARAM TAX SAVER(4)UTI EQUITY TAX SAVINGS

(5)PRINCIPAL TAX SAVER

3.BOND FUNDS

(1)PRINCIPAL INCOME (2)LICMF BOND FUND

(3)DSPML BOND FUND(4)SUNDARAM BOND FUND

(5)UTI BOND FUND

4. GILT FUNDS

(1)KOTAK GILT(SAVING) (2) PRINCIPAL G SEC(SP)

(3)HDFC SOVEREIGN GILT(SP)(4)TAURUS LIBRA GILT

(5)HDFC GILT FUND(ST)

5. LIQUID FUNDS

(1)DSP –ML LIQUIDITY(2)ING VYSYA LIQUID

(3)RELIANCE LIQUID TP(4)PRI ICICI LIQUID

(5)GRINDLAYS CASH FUND

6. BALANCED FUNDS

(1)TEMPLETON PENSION(2)HDFC PRUDENCE

(3)DSP-ML BALANCED(4)SSUNDARAM BALANCED

(5)PRUICICI CHILDCARE(G)

7.MIP

(1)PRUCICIMIP(CUM)(2)SBI MAGNUMMIP(3)RELIANCE MEDIUM TERM

(4)ALLIANCE MIP(5)BIRLA MIP PLAN C

3. PERFORMANCE OF PUBLIC AND PRIVATE SECTOR MUTUAL FUNDS

The performance of mutual funds depends on so many factors. The following are some of the important factors:

(a) the performance of mutual funds is reflected in the NAV of the schemes floated by them.

(b) NAV reflects the present value of the units of the scheme.

(c) NAV depends on the type of the scheme.

(d) Performance depends on the political and environmental factors.

(e) The capital, debt and money market scenario at a particular point of time decides the earning capacity of the schemes.

(f) The interest rate scenario also determines the earning capacity of the various schemes.

(g) The expertise of the fund manager of the schemes, his views about the markets and his ability to leverage the funds to optimise the returns are some of the factors for performance.

(h) The regulatory requirements by SEBI, code of conduct by AMFI, statutory legislations by Government also decide the performance.

(i) The performance efficiency is not static. It is dynamic with return levels changing over a period of time for the same schemes depending on the above factors.

(j) The performance efficiency of mutual funds is determined by the ability of the mutual fund to deliver consistent returns over a period of time based on the scheme objectives.

(k) CRISIL (Credit Rating Information Services India Limited) and Value Research are the two agencies which rate the performance of mutual funds based on certain performance parameters. CRISIL rate the schemes under the nomenclature 'Composite Rating Index (CRI). Value Research rate the schemes by awarding stars (5 star, 4 star etc.,) based on performance parameters.

As already mentioned, the investors must read the offer document of the mutual fund scheme very carefully. They may also look into the past track record of performance of the scheme or other schemes of the same mutual fund. They may also compare the performance with other schemes having similar investment objectives. Though past performance of a scheme is not an indicator of its future performance and good performance in the past may or may not be sustained in the future, this is one of the important factors for making investment decision. In case of debt oriented schemes, apart from looking into past returns, the investors should also see the quality of debt instruments which is reflected in their rating. A scheme with lower rate of return but having investments in better-rated instruments may be safer. Similarly, in equities schemes also, investors may look for quality of portfolio. They may also seek advice of experts.

4. UTI – ORIGIN AND OBJECTIVES

Unit Trust of India (UTI) was the starting point of mutual fund history in India, way back in1964.The vision and foresight of the then finance minister, the late Shri.T T Krishnamachari (TTK) .**The objective was to channelise the funds of small investors into the capital market by creating an institution ,** and that resulted in the formation of UTI. The government engaged David Silver, known as the father of mutual funds, as one of the consultants, to create a mechanism and devise an instrument for these investors.

The first phase of the mutual fund history started wit the establishment of Unit Trust of India (UTI) on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India.

In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs.6,700 crores of assets under management.

UTI was the only mutual find operating for a long time since 1964. It was an open ended mutual fund whose units can be sold and repurchased at any time. UTI is a public sector mutual fund enjoying a monopoly position until 1987 and special tax benefits were offered exempting entire income from income tax initially. Subsequently, the exemptions were slowly changed

UTI evolved as a government promoted organisation, which combined in itself the functions of a mutual fund and a financial institution. As a result, UTI was allowed to participate in term financing, which today's mutual funds do not do. Its activities as a financial institution were in keeping with the ethos of the times, which required us to promote industries and also promote the capital markets. By 1987, UTI was managing assets worth Rs 40,000 crores. That was the first phase of the mutual fund sector in India.

Unit Trust of India Act 1963 was repealed in 2003 and UTI was bifurcated into two separate entities.

One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs.29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of india, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations.

UTI Mutual Fund today (sponsored by the above institutions) still leads the pack of mutual funds with 40 schemes under Liquid, Income, Balanced, Asset Allocation, Index and Equity category. Uti has the most comprehensive basket of equity funds-plain vanilla funds, index funds, growth funds, value funds, sector funds, theme based funds, large cap funds, mid cap funds etc., the latest in the stable is UTI Dividend Yield Fund-an equity fund that invests in companies that offer a high dividend yield.

With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs.76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth. As at the end of September, 2004, there were 29 funds, which manage assets of Rs.153108 crores under 421 schemes .

5. SCHEMES OF THE UTI

UTI as the leader of mutual fund industry offer a plethora of schemes for investors. The choices for the investors are wide to match the investment objective, expected return and the risk return appetite.

UTI offer schemes under the following broad categories:

i. Liquid Funds
ii. Income Funds
iii. Balanced Funds
iv. Asset Allocation Funds
v. Index Category Funds
vi. Equity Funds

i. Liquid Funds :

Under liquid funds, UTI offers the following schemes

1. UTI Money Market Fund
2. UTI Liquid Fund-Short Term Plan
3. UTI Liquid Fund –Cash Plan
4. UTI Liquid Advantage Fund

The underlying common objective for these schemes will be steady and reasonable current income and high level of liquidity.

ii. Income Funds :

1. UTI G Sec Fund-Investment Plan
2. UTI G Sec Fund-Short Term Plan
3. UTI –Gilt Advantage Fund-LTP
4. UTI –Gilt Advantage Fund-STP
5. UTI Bond Fund
6. UTI Bond Advantage Fund-LTP
7. UTI Bond Advantage Fund-STP
8. UTI Floating Rate Fund

9. UTI Monthly Income Scheme

10. UTI MIS Advantage Plan

11. UTI Children's Career Plan(Bond)

The underlying common objective for these schemes will be risk free/ low risk attractive returns, capital preservation and easy liquidity.

iii. Balanced Funds :

1.Pure Balanced Funds

a. UTI Balanced Fund

b. UTI US 2002

(Objective: To generate regular income together with capital appreciation)

2.Segment Focussed Funds

a.UTI Mahila Unit Scheme

b.UTI Children's Career Plan

c.UTI Charitable & Religious Trust & Registered Society.

(Objective :To generate reasonable income with moderate capital appreciation)

3.Retirement Benefit/Unit Linked Plans

a.UTI Unit Linked Insurance Plan

b.UTI Retirement Benefit Pension Fund

(Objective :To provide pension to investors after they attain 58 years of age)

iv. Asset Alocation Funds :

1.UTI Variable Investment Scheme

2.UTI Dynamic Equity Fund

(Objective :Primarily equity focussed, Periodical income distribution with contrarian view)

v. Index Funds:

1. Pure Index Funds:

a. UTI Master Index Fund

b. UTI Nifty Index Fund

c. UTI-Index Advantage Fund-Nifty Plan

d. UTI-Index Advantage Fund-Sensex Plan

(Objective :Investing in securities in the same weightage of the index-BSE,NSE Nifty to minimise the performance difference with the index)

2. Enhanced Index Fund:

UTI Index Select Fund

(Objective: Investing in Index stocks with aim to outperform the index)

3. Exchange Traded Fund :

UTI Sunder

(Objective : Provide investment returns closely corresponding to basket of securities in Nifty index)

vi. Equity Funds :

There are four classifications in equity funds category

1. Tax planning Funds: 2 schemes
2. Diversified Funds: 7 schemes
3. Sector Funds: 5 schemes
4. Speciality/Theme Based Funds

(Objective :exclusive investment in equities based on the theme to achieve growth of capital and income distribution.

The details of the above schemes of the UTI gives an idea about the UTI ifs forward looking in designing and marketing of schemes to cater to different needs of the investors.

6. US 64 IMBROGLIO

US-64, an open-ended balanced fund, was UTI's flagship fund. Launched in 1964, it was the oldest fund and commanded a size of Rs 12778 crores as on June 30, 2001. This amount, even after substantial erosions in its total assets, accounts for 13 percent of the entire Indian MF industry. Established under the UTI Act, the Trust has not been accountable to SEBI, which functions as the watchdog in financial markets in the country.

UTI managed Rs 55924 crores in assets as on June 30, which is about 57 percent of the mutual fund industry's total assets. It has about 41 million

accounts of investors through its wide range of 87 funds (UTI has to date launched over 100 schemes), a monumental figure again, which is unmatched by any other fund.

The UTI, in its monopoly days, was the first to whet corporate appetite for high returns from idle money, and the US-64 scheme was the preferred parking lot for much of the 1990s.But as market returns dwindled in the second half of the 1990s, the scheme found its administered pricing policy allowed corporates to exit the scheme at rates well above the underlying net asset value, precipitating the fund's first major crisis in 1998. At that time, public sector funds were still top dogs, accounting for more than 90 per cent of the assets under management, with private sector funds holding a paltry six to seven per cent. But even as the UTI was heading for trouble, private sector funds were beginning to be lured by the same prospect of large corporate funds.

The largest MF in the country, however, rattled the investor community on July 2, 2001 when it announced a ban on the redemption and sale of units under US-64. US-64 has, for years, been looked upon as a symbol of public trust and people from all classes have poured in their savings for steady returns.

The announcement on the ban of redemption and sale of units effectively converted US-64, into a close-ended fund from an open-ended one, wherein one would remain trapped for the next six months. The question under these circumstances was that of providing liquidity to small investors. I.e. how could small investors be provided an exit route considering that most of the corporate houses had already chosen to offload their holdings while the going was still good.

In normal circumstances what an investor has to do to be a holder of US-64 is to fill the form and receive unit certificates or statements of accounts confirming the title within 6 weeks from the date of closure of the subscription. And to redeem the unit certificates again to send a request form to UTI. Dematerialization facility was also available under the scheme by which units can be held in electronic form with a Depository Ltd. But because of the suspension of the sale/repurchases of the units, people were forced to look for other alternative exit routes.

The government gave the Unit Trust of India two weeks to devise a way of allowing small investors to redeem units in its biggest fund. The government wanted the suspension lifted for small investors, as it would have jolted the investor's confidence on the industry in a big way, something that the government did not want to happen. UTI obliged by setting up a committee for the purpose of proposing a way out to end the problem and to help restructure the scheme from the state of shambles that it currently is in.

Under severe criticism for the imbroglio, UTI has finally decided to lift the freeze. The Trust had managed to get loans from financial institutions and insurance agencies such as LIC and IDBI along with several other bodies. This consortium of financial intermediaries provided a loan of Rs. 3000 crores to UTI. The shares held by UTI in the scheme was held as the collateral for the purpose. Considering that UTI would still needed around 1300 crores after this, it had decided to fall back on its development reserve and holdings in real estate and other assets in order to bridge the gap. Under the new arrangement, UTI had allowed individual redemptions upto 3000 units from a small investor. The repurchase price for the purpose had been fixed at Rs. 10 per unit. The Trust has also decided to shift to NAV based pricing from January 2002, just before its deadline (provided under the Deepak Parekh Committee, after the first fiasco) of 3 years ends.

To entice the investors and to ensure that they stick around with the scheme, the Trust had specified that the fund shall be repurchased at NAV or the repurchase price as announced, whichever is higher, after it turns NAV-based. Since this conversion is only in January next year, redeeming at hat time would mean losses for the investors. Even after conversion, the trust would continue to add 10 paise per month to the repurchase price till August 2003. This meant that even if the market does not rebound quickly, investors could still get an assured return. UTI was not expecting to face huge redemption pressure as the scheme had a lot of support from investors and that will also give it enough time to realign its portfolio. Staying with the fund would be profitable for investors as well, for it will mean they will still get more than what is the actual worth of their investments. If the market does bounced back sooner than that, they can always realize good value by redeeming the units at NAV. The trust on UTI however, may not be the same as in one go, UTI had reduced the value of investments made previous year (at around Rs. 14) to Rs. 10. The assured returns

might have been offered at that time but this was little consolation for investors who had entered at higher levels.

Investors stood to gain from that latest mechanism, which had been worked out after a lot of brainstorming. In the best interest of all the concerned parties, the modalities were be worked out properly.

Apart from that solution, one of the solutions proposed was a split in the scheme itself. While one portion could be debt based and traded, the equity portion would have been restructured and continued with the freeze. This could have provided investors with some liquidity over the next few months.

The other option proposed was that of trading the units in the stock exchanges. US-64 falls under the SEBI list of scripts, which are to be compulsorily traded in the dematerialised form. Up to 500 units can, however, be sold or bought through the odd-lot window even in the physical mode. The Delhi Stock Exchange on July 06, 2001 started trading in US-64 units in the debt segment under the demat mode and also opened the odd-lot window which allowed investors to buy or sell a maximum of 500 US-64 units. The opening of the odd-lot window by stock exchanges will, however, benefit only the first owners of the US-64 units because the subsequent buyers of units would not be able to sell them through this mode. The route is not as simple though. With uncertainties about its NAV prevailing, the demand for the scheme has gone down as well pushing down the prices and making this route virtually non-viable without incurring losses.

On the whole, the latest proposition as put forth by the Trust is beneficial for both the parties under that scenario. For the investors, it gave them an option to redeem if they want to - although it may be at a loss, as the market was not showing any signs of consolidation. For UTI, it was not just a face saving mechanism but also one that bought it more time to realign itself with the market. However, there was no assurance of sustaining the repurchase price, for what had happened twice can happen again.

The Unit Trust of India had finalised modalities in July 2001for raising Rs 3,000 crores through a soft loan from a consortium of banks and financial institutions, including State Bank of India, Industrial Development Bank of India, Life Insurance Corporation of India and Bank of Baroda.

The loan was obtained at a sub-PLR rate of interest, and used to restructure the Unit Scheme 64.

7. PRESENT STATUS OF UTI

UTI has positioned itself as a large and professionally managed organisation with sound infrastructure, readiness to cope up with change, a good market presence, good governance practices and professional fund management. In addition, they are transparent, progressive, dynamic and technology-savvy. They are communicating theses messages through marketing and advertising communications including brochures, POP material, attitude and approach of sales force, lenience of service team, distributor/investor meets etc.

UTI has built capabilities over the years in the areas of new product development, research, information processing, customer grievance handing etc. to help it deliver better value to its customers at competitive costs. They have taken extra care to process information and handle customer grievances. Customer Service Delivery was achieved through the UTI Financial Centres (UFCs) and the Central Processing Centre (CPC).

UTI has taken a lot of initiatives to build BRAND EQUITY in the minds of the existing and future customers. Through brand equity, they initiated steps to deliver tangible and intangible value propositions, vis-à-vis direct and indirect competition.

As a part of Business Process Re-engineering, McKinsey recommended that UTI revisit its current brand image and redefine its new Corporate Identity to fully capture its future promise of customer orientation while capitalising on the strengths and values that its brand embodies today. Based on the recommendations, UTI embarked upon the exercise of developing Corporate Identity and Branding with Rediffussion. They created a new logo to manifest the changes happening in the organisation, and it's the first step towards building a new corporate identity. The logo conveys characteristics like sense of approachability, humility, dynamism, strength of character, stability with a corporate image that is clean, no-nonsense, down to earth, modern and contemporary.

The colours used in the new corporate logo are unique and imply specific meanings. UTI Orange stands for dynamism, an outward growing colour, sunny, cheerful, bright and young juxtaposed with UTI Blue which gives a sense of calm, maturity, balance, depth and serenity. The white type face 'UTI' encased in deep blue box, while extremely striking, emphasises the clean, pure, and neutral image of UTI Mutual Fund.

The post-launch market study threw up a positive feedback about the recognition and retention values of our new brand identity. UTI has certainly positioned itself at new heights on the horizon of the mutual fund industry.

8.CHALLENGES FOR MUTUAL FUNDS IN THE LIBERALISED ENVIRONMENT

(a) Mutual fund industry has evolved over a period with private and public sector players attracting the investors with focussed, hybrid, value enhancing schemes. But the figures reveal that the institutional investment forms the core of mutual funds and retail investors participation has to be improved to improve the performance. Since mutual fund investments attract concessional tax rates as against direct investment in securities, these products became hot favourites among corporate customers. While the product is custom made to pass the benefit of tax-arbitrage to preferred customers, such products are not made available to retail investors. Mutual funds also chase institutional investment because of the low cost of servicing as compared to retail investors. In fact, institutional investment subsidises the cost of retail servicing for the mutual funds.

(b) Retail participation will improve only with improvement in customer confidence on the mutual funds' ability to deliver consistently higher returns than competing financial products. To achieve this mutual funds could have more equity in fund portfolios. The big retail growth in the US happened on the back of a long-term equity boom, but in India the equity markets have not really outperformed other asset classes in the decade after 1994 – when the first private sector equity fund got launched.

(c) In this context, most savers were happy enough with the returns available in bank fixed deposits – till the dramatic drop in interest rates over the last three years.

(d) If all this made selling mutual funds to retail investors a tough proposition, the AMCs did not improve things by mis-selling schemes. Just as public sector mutual funds eroded their credibility by offering assured returns and then failing to keep their promises, the private sector funds made a mess of investor sentiment by launching tech funds at the height of the dotcom boom and them wiping out assets values in the bust that followed.

(e) With the equity markets providing smart returns in 2003, many fund houses launched and promoted Monthly Income Plans (MIPs) with equity components of up to 20 per cent. Things went fine till early 2004, but once the equity boom cooled post-election, many MIPs failed to live up to their names. The problem is due to the funds not telling investors about the risks of having equity in an income-oriented portfolio. The industry has mis sold the products resulting in poor performance and decline in customer confidence about mutual funds.

(f) A key turning point for the industry, though, was the onset of the declining interest rate regime after 2000. As rates fell steadily, debt-oriented schemes reported prodigious capital gains, attracting the interest of corporate investors. That's when the funds made a shift in strategy by focusing on big money.

(g) Mutual funds made more efforts to devise schemes for institutional investors than retail ones. That's how they launched 'serial schemes' that were virtually portfolio schemes, with little efforts being made to disguise them. Though serial schemes have since received the axe, even now mutual funds have fixed maturity plans (FMPs) that are often quid pro quo arrangements with small banks for getting higher-than-market returns on their funds.

(h) For too long, mutual funds have taken advantage of tax breaks and allowed themselves to be led (in the direction of institutional investors). Mutual funds have to make a conscious effort to make mutual funds a vehicle for the retail investor, who are their real customers.

(i) One area where the funds have failed is in investor education – despite efforts by funds like Templeton. Though many funds hold investor camps regularly, and there are even attempts at improving awareness, it is nobody's claim that investors are now well informed. Some cynics in the industry believe that "investors, driven by greed, can't really be educated." Mutual funds have to take steps to improve investor education. Investor education is an ongoing effort and will eventually bring its rewards – but in the long run.

(j) Another big challenge before the industry, is to provide a transition path for investor funds away from government-sponsored, risk-free products to market-related instrument. The future growth will depend on funds' ability to push products and garner a higher share of the household savings of the Indian investor.

(k) The litmus test for the industry is the expansion of the distribution network to smaller urban and rural areas where most of the small investors live. The challenge would be to educate these investors about the advantages of investing in mutual funds compared to traditional saving instruments."

(l) Importantly, the mutual fund industry needs an image makeover. The image management has to be improved. Convincing the small and really retail investor will take some doing, and will also cost the funds some money. The sooner they get started on it, the better.

(m) What strategic choices does the future hold for mutual fund companies? Enormous possibilities exist for mutual funds to differentiate themselves Individual companies, based on their own objectives and strengths, can choose to position themselves to exploit these opportunities. For example, the opportunity of pension reform can be exploited by some mutual funds by positioning themselves as the front-runners in the Pension Fund arena. Similarly, companies that pioneer distribution channels of Financial Planners and E-commerce will stand to benefit enormously if these trends gain significance. The future sales will come from niche products.

In the words of Morgan Stanley Dean Witter, "In the end, not all asset management (mutual fund) companies will survive, [but] for firms that have built a 'culture of excellence' over the years, have segmented their customers

efficiently, built brand, and delivered performance, the ongoing opportunities to take market share have never been more significant."

SUGGESTED QUESTIONS

1. Elaborate the measures taken by SEBI to improve the functioning of mutual funds.
2. Explain by a chart the different public and private sector mutual funds.
3. List the important schemes on mutual funds with examples.
4. What are the factors that will shape the future of the mutual fund industry.
5. Elaborate the important factors that determine the performance of public and private sector mutual funds.
6. Write a note on the origin and objectives of UTI.
7. What are the broad categories of schemes offered by UTI. List the schemes under each category.
8. Write a note on US 64 imbroglio.
9. Discuss elaborately the challenges facing mutual funds in the present scenario.

MODEL QUESTION PAPER

Paper 4.4 : MUTUAL FUND MANAGEMENT

Time: 3 Hours Max. Marks: 100

SECTION - A (5 x 8 = 40)

Answer any **Five** questions

All questions carry equal marks

1. What are mutual funds? Explain briefly the concept of mutual funds.
2. Discuss the features of Equity Linked Savings Schemes and Sector Funds.
3. Explain the features of Floating Rate Funds and Fund Of Funds?
4. Write a note on the Sponsor of a mutual fund.
5. What is the procedure for investing in and filling up of an application form for mutual fund scheme?
6. Write a note on the various steps in winding up of mutual funds.
7. What is Net Asset Value? Explain how to calculate Net Asset Value.
8. What are the factors that will shape the future of the mutual fund industry?

SECTION - B (4 x 15 = 60)

Answer any **Four** questions

All questions carry equal marks

9. Explain briefly the working of mutual fund by a flow chart.
10. What is portfolio classification of mutual funds? Explain in detail the salient features of income, growth and balanced schemes ?
11. Explain elaborately the functions of an Asset Management Company?
12. Explain in detail the customer segments and preferences, customer profile and characteristics of mutual fund market in India
13. Discuss in detail the people, process and promotion elements of marketing plan of mutual funds.
14. Explain the features of regulations regarding listing and repurchase of Close Ended Schemes
15. Elaborate the important factors that determine the performance of public and private sector mutual funds.

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